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### Political Justice and Tax Policy: The Social Welfare Organization Case

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POLITICAL JUSTICE AND TAX POLICY: THE  
SOCIAL WELFARE ORGANIZATION CASE

by: Philip Hackney\*

ABSTRACT

*In addition to valuing whether a tax policy is equitable, efficient, and administrable, I argue we should ask if a tax policy is politically just. Others have made a similar case for valuing political justice as democracy in implementing just tax policy. I join that call and highlight why it matters in one arena—tax exemption. I also further that discussion by arguing that politically just tax policy does the least harm to the democratic functioning of our government and may ideally enhance it. I argue that our right to an equal voice in collective decision-making is the most fundamental value of political justice. To test this case, I evaluate our choice to exempt “social welfare organizations” from the U.S. income tax. In addition to efficiency and equity, I also ask whether the policy is politically just in a democratic sense. I examine three models of democratic justice: liberal, republican, and deliberative. In making the democratic case, I try to find commonalities among the three in order to further what an agreed upon notion of democratic justice might look like in the tax context. I contend that the notion of democratic justice must exist at the substantive level of the Internal Revenue Code (“Code”). This Code-level application demonstrates that the typical criteria of efficiency and fairness do not provide sufficient criteria to evaluate the justice of tax-exempt policy. Political justice provides additional important evaluative criteria. There are likely significant other parts of income tax policy that need to be considered from the value of political justice as democracy as well.*

TABLE OF CONTENTS

I. INTRODUCTION.....	272
II. WHY POLITICAL JUSTICE? .....	278
A. <i>Why Democratic Justice Instead of Another Type of Justice?</i> .....	278
B. <i>Three Democratic Traditions</i> .....	282
C. <i>How Does Democratic Justice Apply to Income Tax?</i> .....	288
III. SOCIAL WELFARE ORGANIZATION LEGAL REGIME.....	291
A. <i>The Law Regarding Qualifying as a Social Welfare Organization</i> .....	292

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B.	<i>What Types of Organizations Make Up the Social Welfare Organization Community?</i> .....	298
1.	Advocacy Social Welfare Organizations .....	299
2.	Health-Related Social Welfare Organizations...	300
3.	Service-Club Social Welfare Organizations .....	300
4.	Homeowners' Association Social Welfare Organizations .....	301
C.	<i>Tax Consequences of Forming as a Social Welfare Organization</i> .....	302
IV.	RATIONALES FOR TAX EXEMPTION .....	303
V.	ANALYSIS .....	308
A.	<i>Social Welfare Organizations as a Part of Civil Society</i> .....	309
B.	<i>Is Tax Exemption for Social Welfare Organizations a Subsidy?</i> .....	311
C.	<i>What Does Democratic Political Justice Say About Providing a Subsidy to Social Welfare Organizations?</i> .....	316
D.	<i>Advocacy Organizations</i> .....	318
E.	<i>Health Service and Insurance</i> .....	323
F.	<i>Community Clubs/Homeowners' Associations</i> .....	324
G.	<i>IRS as the Arbiter of Legitimate Public Activity Harms Us and the IRS</i> .....	326
H.	<i>Assuming Social Welfare Organizations Maintain Exemption, What Ought We to Do, Keeping Politics Justice in Mind?</i> .....	327
I.	<i>Application to Charitable Organizations</i> .....	328
VI.	CONCLUSION .....	329

## I. INTRODUCTION

Much tax policy scholarship adopts the maximization of a social welfare function as its guidepost<sup>1</sup> or attempts to show whether tax policy is unfair economically to some classes of people.<sup>2</sup> Tax policy schol-

1. See, e.g., David A. Weisbach & Joseph Bankman, *The Superiority of an Ideal Consumption Tax Over an Ideal Income Tax*, 58 STAN. L. REV. 1413 (2006) (arguing in effect that economically an ideal consumption tax will generate greater social welfare than an ideal income tax); LOUIS KAPLOW, *THE THEORY OF TAXATION AND PUBLIC ECONOMICS* xvii (2008) (stating that the social objective of the normative study of taxation is "taken here to be the maximization of a conventional social welfare function . . ."). But cf. Eric M. Zolt, *The Uneasy Case for Uniform Taxation*, 16 VA. TAX REV. 39, 62 (1996) [hereinafter *Uniform Taxation*] (arguing generally for the maximization of a social welfare function, but acknowledging "[a] society may choose an inefficient allocation of resources based on concerns of equity or justice or other criteria").

2. See, e.g., Reuven S. Avi-Yonah, *The Three Goals of Taxation*, 60 TAX L. REV. 1 (2006) (adopting both the maximization or social welfare and economic unfairness arguments, but also arguing that tax is used to regulate); C. Eugene Steuerle, *And Equal (Tax) Justice For All?*, in TAX JUSTICE: THE ONGOING DEBATE 253 (Joseph J.

arship that seeks to maximize a social welfare function is scholarship that considers how to enhance aggregate economic welfare through tax policy (a “best-results” theory, and also a tax policy focused on “efficiency”). Scholarship analyzing whether a policy is unfair economically primarily focuses on whether a tax policy unfairly advantages some group over another, usually in an economic sense (in tax policy “fairness” or “equity”).<sup>3</sup> I argue that we should also ask whether a tax policy is politically just. By politically just, I mean tax policy that does not hinder an equal voice in our collective decision-making, and may even promote it. We should pursue not just a best-results vision of justice in tax policy, but a popular-will sense of justice as well.

Others have made a case for the importance of political justice as democracy in implementing tax policy.<sup>4</sup> I join them in stressing the importance of considering political justness in formulating tax policy and emphasize why it matters in one arena—tax exemption. I advance the discussion by arguing that politically just tax policy does the least harm to the procedural democratic functioning of our government and may ideally enhance that functioning. I argue that our right to an equal voice in collective decision-making is the most fundamental value of political justice (“political voice equality” or “PVE”).

To test this political justice case, I consider the exemption of social welfare organizations from the U.S. income tax.<sup>5</sup> A social welfare organization is a non-profit entity that must be “operated exclusively”

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Thorndike & Dennis J. Ventry, Jr. eds., 2002) (arguing equity is a more fundamental value than efficiency and that we must measure people vertically and horizontally to ensure equal treatment according to ability and well-being).

3. See, e.g., William D. Andrews, *A Consumption-Type or Cash Flow Personal Income Tax*, 87 HARV. L. REV. 1113, 1115 (1974) (arguing that an income tax unfairly places a heavier burden on those who invest income in the current year compared to those who consume). See Michael A. Livingston, *Reinventing Tax Scholarship: Lawyers Economists and the Role of the Legal Academy*, 83 CORNELL L. REV. 365, 374 (1998) (arguing that the traditional tax policy criteria of efficiency and fairness implicitly take an economics frame).

4. See, e.g., James R. Repetti, *Democracy and Opportunity: A New Paradigm in Tax Equity*, 61 VAND. L. REV. 1129, 1131 (2008) [hereinafter *Democracy and Opportunity*] (arguing that tax policy as fairness should be about providing equal opportunity to all citizens to achieve self-realization); Joseph T. Sneed, *The Criteria of Federal Income Tax Policy*, 17 STAN. L. REV. 567, 568 (1965) (arguing that one of the factors tax policy sets out to accomplish is a “harmony between the income tax and the sought-after political order”); Clinton G. Wallace, *Tax Policy and Our Democracy*, 118 MICH. L. REV. 1233 (2020) (arguing we should build the democratic value of accountability into our making of tax policy); John R. Brooks, *The Definitions of Income*, 71 TAX L. REV. 253, 253 (2018) (“‘[I]ncome’ is whatever society wants it to be in order to achieve a result that the democracy believes to be appropriate and just.”); Ari Glogower, *Taxing Inequality*, 93 N.Y.U. L. REV. 1421, 1449 (2018) (arguing tax policy should consider relative economic power theory, which shows that we should limit “opportunities for social dominance resulting from excessive imbalances of economic power”).

5. Social welfare organizations derive an exemption from income tax from 26 U.S.C. § 501(c)(4)(A).

for the “promotion of social welfare.”<sup>6</sup> In addition to the criteria of efficiency and equity, I ask whether the policy is politically just in a democratic sense.<sup>7</sup> I examine three models of democratic justice: liberal, republican, and deliberative. While I am inclined toward the deliberative form of democracy, I try to find commonalities among the three in order to determine an agreed-upon notion of democratic justice. Also, I argue that the notion of democratic justice must exist at the substantive level of the Internal Revenue Code (“Code”) rather than just in the way tax policy is made, the choice of base or whether the marginal rate structure is redistributive.<sup>8</sup> This Code-level application demonstrates that the typical criteria of efficiency and fairness do not provide sufficient parameters to evaluate the justice of tax-exempt policy.

IRS data show that in 2016 over 80,000 social welfare organizations were registered with the IRS and collectively earned over \$86 billion in revenue.<sup>9</sup> Politically active groups like the NRA and the ACLU are social welfare organizations, as is Karl Rove’s Crossroads GPS, and other groups that support candidates for office.<sup>10</sup> So are some big health maintenance organizations.<sup>11</sup> Finally, the sector is comprised of Rotary clubs, Kiwanis clubs, kids’ sports associations, homeowners’ associations, and more.

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6. *Id.*

7. Others have made arguments about the justness of policy associated with charities based on political justice. See Robert Atkinson, *Keeping Republics Republican*, 88 TEX. L. REV. SEE ALSO 235, 246–47 (2011) (arguing that tax policy ought to be designed in alignment with a republican conception of political justice with a healthy skepticism of voluntary organizations and most things provided by the state); ROB REICH, JUST GIVING 195–98 (2018) (referring to the idea that current tax law regarding charity provides too much voice to the wealthy in our democratic order); Philip Hackney, *Prop Up the Heavenly Chorus: Labor Unions, Tax Policy, and Political Voice Equality*, 91 ST. JOHN’S L. REV. 315, 317–18 (2017) [hereinafter *Prop Up the Heavenly*] (arguing that tax exemption policy for labor and business interests distinctly favored business interests and was therefore not democratically just).

8. My argument in Part I for democracy as justice is largely a procedural argument. As a result, there is a question as to whether I am making a procedural or a substantive claim. It is both. Congress in passing substantive tax policy is impacting procedural justice by granting greater benefits to those with greater political voice already. This is a substantive claim. Additionally, I believe my claim that there is a political harm from Congress making the IRS make collective value judgments is both substantive and procedural.

9. JEREMY KHOULISH, FROM CAMPS TO CAMPAIGN FUNDS: THE HISTORY, ANATOMY AND ACTIVITIES OF 501(c)(4) ORGANIZATIONS 6 (2016), [https://www.urban.org/sites/default/files/publication/77226/2000594-From-Camps-to-Campaign-Funds-The-History-Anatomy-and-Activities-of-501\(c\)\(4\)-Organizations.pdf](https://www.urban.org/sites/default/files/publication/77226/2000594-From-Camps-to-Campaign-Funds-The-History-Anatomy-and-Activities-of-501(c)(4)-Organizations.pdf) [https://perma.cc/U6P2-VRQ7] [hereinafter FROM CAMPS TO CAMPAIGN FUNDS]; see also Ellen P. Aprill, *Examining the Landscape of Section 501(c)(4) Social Welfare Organizations*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 345, 360–67 (2018) [hereinafter *Examining the Landscape*] (demonstrating that this number likely significantly undercounts the number of social welfare organizations in existence).

10. See *infra* Part II (B).

11. See *infra* Part II (B).

Social welfare organizations are a significant part of civil society.<sup>12</sup> By *civil society*, I mean the institutional spaces and organizations outside of the government, and outside of economic power, that facilitate and influence collective decision-making at the state level.<sup>13</sup> Civil society includes institutions such as the press, voluntary organizations, churches, schools, and places where people publicly congregate. All of the social welfare sector, including kids' sports associations and health maintenance organizations ("HMO"), fit into this broad category. As such, the social welfare organization sector plays a significant role in shaping and providing collective goods and services and in developing collective opinions within civil society and outside of the state.

The social welfare organization tax exemption violates the principle of providing equal political voice in two ways. First, the policy arbitrarily uses a market model to distribute this tax benefit. This randomly provides a greater subsidy to individuals with greater access to human and material resources compared to those with limited resources. Second, and equally important, the highly vague standard of social welfare puts the IRS in the untenable position of deciding which organizations are furthering our best collective interest. This harms the citizens of the United States in a political justice sense because it creates a collective choice mechanism that is not transparent and not made by citizens. Also, because of the vague standard of social welfare and the requirements of tax privacy, the IRS is forced to make political judgments in a nontransparent matter for us all. This violates both equal political voice and its appearance, and in the process harms the appearance of the neutrality of the IRS.

From a political justice perspective, we should end the policy of tax exemption for social welfare organizations that engage in education and advocacy for partisan purposes. Unintuitively, taxing them advances the policy of neutrality as to these interests because it helps level the playing field between advocacy groups that do not have a tax benefit and those that do. Providing a tax exemption fails in an equity sense because the exemption is only available to those interest groups (i.e., organizations outside the government organized to influence the government on the interests of its members)<sup>14</sup> with the capacity to

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12. Peter Dobkin Hall, *Philanthropy, the Nonprofit Sector & the Democratic Dilemma*, 142 DÆDALUS 139, 139 (2013) (noting that nonprofits writ large are widely regarded as "quintessentially civic institutions," while at the same time questioning whether they are all truly above the fray and to be trusted).

13. Jürgen Habermas, *Three Normative Models of Democracy*, 1 CONSTELLATIONS 1, 8 (1994) [hereinafter *Three Normative Models*] (arguing that civil society is outside of the government and the economic power and makes up the facility for people to form opinions in the public sphere outside of those two significant forces). For a rich and deep discussion of the role civil society has played in political theory over a wide range of political theorists and within their theories, see JEAN L. COHEN & ANDREW ARATO, *CIVIL SOCIETY AND POLITICAL THEORY* (4th ed. 1992).

14. See Philip T. Hackney, *Taxing the Unheavenly Chorus: Why Section 501(c)(6) Trade Associations Are Undeserving of Tax Exemption*, 92 DEN. U. L. REV. 265, 273

make use of this governmental benefit. Additionally, the exemption fails in an efficiency sense because it delivers a benefit to those who do not need the help and gives nothing to those who do. A far better policy in a political justice sense would be for the government to give every person in the United States \$100 a year to give to interest groups or advocacy organizations that best represent their interests.

What about the other social welfare organizations that provide collective services or goods rather than advocate positions? For instance, Delta Dental, described in Part II.B, provides insurance for dental services. Rotary Club, described in Part II.B, connects businesspeople in a community to meet and speak with one another about important community matters and to provide community service. Homeowners' associations provide security, maintenance, and connectivity for neighborhoods.

Neither fairness nor efficiency analyses help much in assessing these organizations, but the political justice analysis provides insight. Tax exemption for the other category of social welfare organizations fails on political justice grounds for two reasons, both associated with the vague standard applied. First, our collective decisions should be made by a process that values PVE. A representative body of the people should shape what collective goods get the imprimatur and benefits of the government. Instead, that imprimatur and benefit is delivered arbitrarily and primarily through a market mechanism. The IRS and courts do their best with a vague standard set by Congress, but the result is haphazard, as the IRS itself recognizes, but fundamentally the decisions are driven by an agency and courts rather than Congress. That arbitrariness is exacerbated because the benefit accrues in greater amount through a market mechanism to any organization that has greater resources and is more successful economically because the primary benefit flows from taxes avoided. Second, though the IRS has issued some guidance that is transparent, the IRS does a lot of work in shaping the legal lines of the benefit through its application system. That system lacks transparency. This both prevents all citizens from shaping these collective decisions and carries out that activity in a nontransparent manner. From a political justice standpoint, I believe we would be better off eliminating the exemption altogether.

Like others, I am not expecting Congress to eliminate tax exemption for social welfare organizations any time soon.<sup>15</sup> If we are to maintain the tax preference, political justice would demand Congress clarify which organizations should qualify.<sup>16</sup> Clearer Congressional

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(2015) [hereinafter *Taxing the Unheavenly*] (citing JOHN R. WRIGHT, INTEREST GROUPS AND CONGRESS: LOBBYING, CONTRIBUTIONS, AND INFLUENCE 22–23 (1996) (defining the term interest group)).

15. See *Examining the Landscape*, *supra* note 9, at 359.

16. Admittedly, this would seem to be in some conflict with an argument I made in a prior article regarding how rules might be best adopted regarding charitable orga-

rules could eliminate some transparency concerns and highlight that representatives of the people democratically determined the categories of organizations to receive the benefit of tax exemption. We could also aim to improve the democratic nature of social welfare organizations. For instance, we might adopt principles that the three democratic traditions agree upon in what civil society ideally would look like. I discuss these possibilities more in Part IV below.

I also compare the political justice analysis with two theories that have emerged as the dominant rationales for tax exemption:<sup>17</sup> contract failure and government failure. In contract failure, there is a failure of the market to provide certain important goods and services.<sup>18</sup> Tax exemption is then viewed as a subsidy to help provide a more efficient level of those goods and services. In the latter, our government will only provide the collective services and goods of the median voter.<sup>19</sup> Under this theory, many view tax exemption as a subsidy to allow minority groups to provide the collective goods and services they desire that the government does not provide. I conclude that while these two efficiency-based theories continue to offer a useful lens to consider tax policy on the matter of tax exemption, adding a political justness factor is vital because it enhances tax policy design. The two theories (contract failure and government failure) are myopic because they determine a sense of justness based on a vision of a perfect market. As for the application of a political justice critique to the rest of the tax code, this Article concludes that such a project is a worthwhile endeavor.

Part I explains the adoption of a political justice analysis to critique tax policy and considers its benefits and its limitations. Part II discusses the positive law associated with social welfare organizations and describes and categorizes some of the activities that take place in the sector. Part III considers previous analyses of theories of tax exemption, including those that focus upon social welfare organizations. Part IV analyzes the exemption from income tax for social welfare

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nizations. See Philip Hackney, *Charitable Organizations Oversight: Rules v. Standards*, 13 PITT. TAX REV. 83, 85 (2015). I argued Congress ought adopt broad standards and allow the IRS to adopt more specific rules to regulate the charitable sector. *Id.* It still gives me pause to have Congress adopt more specific rules in this sector. Perhaps there is a way to make the IRS process more publicly accountable so that it would be seen and be more democratic in nature. This is beyond the scope of this Article though.

17. There is much scholarship that looks at the rationale for charitable contribution deductions. These are different and I am not expressly discussing them here. See, e.g., William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 346 (1972).

18. Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 66, 68 (1981) [hereinafter *The Rationale*].

19. Burton Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy*, in THE ECONOMICS OF NONPROFIT INSTITUTIONS 21, 26 (Susan Rose-Ackerman ed., 1986) [hereinafter *Theory of the Voluntary*].



organizations as well as the tax treatment of contributions, both from an income tax and a gift tax perspective. Part V concludes.

## II. WHY POLITICAL JUSTICE?

In this Part, I argue that tax policy analysis ought to include a political justice analysis. In other words, rather than focusing only on a best-results analysis (in a largely economic sense), we ought to consider matters of a just and legitimate political system. That system should promote PVE or at least not hinder it. The traditional tax policy values of equity and efficiency are largely driven by a best-results vision of justice.<sup>20</sup> We ought to consider a popular-will sense of justice as well.

I first develop the moral case for why political justice is grounded in a democratic order and why it is an important value to consider in addition to efficiency and equity in evaluating tax policy. Because pure democracy is utopian in nature, however, I consider a few archetypal models of democracy in an imperfect, pluralistic world. Reviewing these models allows us to apply real-world democratic options to tax policy. The three models include liberal, republican, and deliberative democracy. Though I have in mind a more deliberative democracy vision, I include the other two to see where the three may have some commonalities. In those commonalities, we might find principles to inform a political justice upon which we could have a consensus to make tax policy. Finally, I consider how we ought to think about the role of political justice as applied to the tax system.

### A. *Why Democratic Justice Instead of Another Type of Justice?*

What are the fundamental criteria people use when they argue about the wisdom of a particular tax? Typically, experts discuss equity, efficiency, and administrability. For instance, the income tax is thought to be equitable because a taxpayer pays tax based on her ability to pay, with *income* determining the ability to pay.<sup>21</sup> This is argua-

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20. Steuerle, *supra* note 2, at 253.

21. Alan Gunn, *The Case for an Income Tax*, 46 U. CHI. L. REV. 370, 379 (1979). There are other senses of justice that philosophers have considered, such as the benefit principle, i.e., we should be taxed in accord with the benefits we receive from government or taxation ought to be transactional. *Id.* at 373. This also suggests a “distributive” sense of justice—i.e., we each get our just desserts based on how much we benefit from government activity. Of course, in the economic sense of efficiency, in a perfect market with perfect information, any tax, except a lump sum tax, is inefficient necessarily because it harms the distributional system of the market. For a defense of the ability to pay principle and a critique of the benefit principle and the new benefit principle, see Joseph M. Dodge, *Theories of Tax Justice: Ruminations on the Benefit, Partnership, and Ability to Pay Principles*, 58 TAX L. REV. 399, 405–06, 450–51 (2005).

bly fair based on the equal economic sacrifice of all taxpayers.<sup>22</sup> A broad-based income tax is thought to be efficient, and thus perhaps just, because it generally taxes all sources of income the same.<sup>23</sup> As such, it does not distort market choices beyond the tax charge laid across the economy.<sup>24</sup> Someone might contend that efficiency can be considered just in a utilitarian sense because it might lead to greater social welfare.<sup>25</sup> Regardless of its just nature, in arguing for the correctness of a tax, experts today rely much on economic analysis and largely on a tax's capacity to efficiently distribute burdens across taxpayers. This economic critique in tax today is king.

Liam Murphy and Thomas Nagel famously argued that tax scholarship that focuses on equity and efficiency is myopic.<sup>26</sup> By assuming individuals are entitled to their pretax income, tax theories operate on a presupposition that the right to private property is a natural right rather than a socially constructed right.<sup>27</sup> In other words, private property does not exist without the invention of the state, and a state does not exist without revenue from tax. Murphy and Nagel contend that both the equity and efficiency arguments rely upon this incorrect presupposition and lead tax scholars down arguments that rely upon false propositions. That myopia includes another presupposition: that the market is a just way of distributing scarce goods and power. As Jane Mansbridge states, economists “not only accept the ‘marketplace’ vision of a society based on self-interest but make it an ideal.”<sup>28</sup> Tax theorists arguably often do the same—Nagel and Murphy argue we

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22. See, e.g., JOHN STUART MILL, *PRINCIPLES OF POLITICAL ECONOMY*, Book 5, Chapter 2, § 2 (1885) (“Equality of taxation, therefore, as a maxim of politics, means equality of sacrifice.”); LIAM MURPHY & THOMAS NAGEL, *THE MYTH OF OWNERSHIP* 20–30 (2002) [hereinafter *MYTH OF OWNERSHIP*] (broadly discussing ability to pay rationales that are more extensive than equal sacrifice).

23. *Uniform Taxation*, *supra* note 1, at 62–63. Some have argued that a consumption tax is more efficient than an ideal broad-based income tax. See Weisbach & Bankman, *supra* note 1. Because the current exemption is from income tax, this Article focuses upon exemption within an income tax.

24. *Uniform Taxation*, *supra* note 1, at 62–63. Progressive and regressive rates challenge this rationale of course, but there may be reasons of efficiency to lay different rates across the economy as demonstrated by Zolt and Ramsey. Others fundamentally question whether there is any content in the idea of *efficiency* at all. See Neil H. Buchanan & Michael C. Dorf, *A Tale of Two Formalisms: How Law and Economics Mirrors Originalism and Textualism*, 106 CORNELL L. REV. (forthcoming 2020) (stating: “the very idea of efficiency is empty without a highly contestable set of value judgments”).

25. *MYTH OF OWNERSHIP*, *supra* note 22, at 23 (discussing the utilitarian justice basis of such arguments).

26. *Id.*

27. *Id.* at 8.

28. JANE J. MANSBRIDGE, *BEYOND ADVERSARY DEMOCRACY* 17 (Univ. Chi. Press rev. ed. 1983); see also Douglas Rae, *The Limits of Consensual Decision*, 69 AM. POL. SCI. REV. 1270, 1270 (1975) (discussing that Knut Wicksell, Buchanan, and Tullock are wrong in claiming that consensual decision is socially efficient).

should focus on societal justice rather than tax justice as we consider tax policy.<sup>29</sup>

From an economics perspective, the distribution of resources through perfect market mechanisms is ideal because they supposedly deliver goods to those who value them most highly. But, standing on economics alone fails to do justice—to the extent the economic domain cares for moral matters it tends to define them in a utilitarian manner alone.<sup>30</sup> The economic method of critique is hollow because it fails to acknowledge the moral dimension of distributing scarce resources. It is hollow also because it does not fully describe the world within which we live. The market cannot actually clear all goods in an economically efficient manner. There is no pure market.<sup>31</sup> We need a government as a collective decision-making system to create and maintain social structures within which the market operates and through which the market is controlled. The focus on economics in tax policy scholarship obscures this necessary relationship of the system of taxation to the provision of collective properties.

Our system of taxation bears a fundamental relationship with our collective use of resources and our providing of collective properties. The idea of a collective property of society is one which “in order to change one person’s welfare with regard to this property one must change all or almost all of the other members’ welfare with regard to it.”<sup>32</sup> Collective properties include our laws that regulate ownership of property, laws to regulate the environment, and the distribution of resources. This list is likely endless, and endlessly debatable, but makes up the stuff of which we in society make laws about and operate a government to enforce. We raise taxes to provide these collective properties, and the tax system in turn is a collective property. Importantly, the tax system itself creates and makes changes to collective properties existing in society.

If economics alone cannot establish the justness of a tax system, where might we look? Because taxation is a necessary element in establishing and maintaining a state in order to provide collective properties, it necessarily impacts questions of political justice. As James Repetti notes, the tax base and its progressivity should be shaped with thoughts of political justice in the sense of equality of opportunity.<sup>33</sup> I contend that the justice of the tax system should not simply end at the construction of the base and its progressive nature,

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29. MYTH OF OWNERSHIP, *supra* note 22, at 173.

30. KENNETH J. ARROW, *THE LIMITS OF ORGANIZATION* 21 (1974).

31. *Id.* at 22.

32. THOMAS CHRISTIANO, *THE RULE OF THE MANY: FUNDAMENTAL ISSUES IN DEMOCRATIC THEORY* 60 (1996) [hereinafter *RULE OF THE MANY*].

33. *Democracy and Opportunity*, *supra* note 4, at 1143 (“A tax system should be designed to achieve equal opportunity for self-realization as one of its principal goals.”).

nor just in the procedures used to enact it. We should consider ways in which individual code provisions may impact political justice.

By political, I mean how we decide what the group is going to do. There are a few different primary answers to the question of who ought to decide what the group is going to do: (a) no one, or *anarchy*; (b) some select group of people, or *guardianship*; and (c) everyone, or *democracy*.

In a previous article, I discussed why we should prefer democracy as a matter of political justice over other forms of government such as guardianship or anarchy.<sup>34</sup> The case for democracy is based on the principle of intrinsic equality.<sup>35</sup> That is to say that no one is better than an individual in deciding what that individual should do in life. As a result, all individuals ought to have an equal say in what a relevant group decides to do. As Thomas Christiano explains, “[a] person’s right to participate in the shaping of the world she shares in common with others, which characterizes a well-functioning democracy, is grounded in her fundamental interests as a member of political society.”<sup>36</sup>

Democracy demands more than majority-rule governance.<sup>37</sup> Crucially, each member of a group (typically all competent adults) must have an equal and real opportunity to have a say in the group’s agenda. This means government should afford all individuals the ability to ask questions, seek relevant information, and hear arguments such that all individuals have an opportunity to fully understand the consequences of the decision at hand. Additionally, everyone must have a vote in any final decision. These requirements establish a principle Robert Dahl referred to as inclusion,<sup>38</sup> and that value can also be described as political voice equality.

Christiano adds another element to the principles of democracy. To have equality, equality must be seen—it must be publicly realized.<sup>39</sup> Institutions “must be able to display the fact of their justice to ordinary persons.”<sup>40</sup> This is consistent with Immanuel Kant’s formula of public right: “[a]ll actions affecting the rights of other human beings are wrong if their maxim is not compatible with their being made pub-

34. *Prop Up the Heavenly*, *supra* note 7, at 316.

35. In sketching that account of democracy, I relied significantly upon the work of Robert Dahl. In particular: ROBERT A. DAHL, *DEMOCRACY AND ITS CRITICS* (1989) [hereinafter *DEMOCRACY AND ITS CRITICS*]; ROBERT A. DAHL, *ON DEMOCRACY* (2d ed. 2015); ROBERT A. DAHL, *HOW DEMOCRATIC IS THE AMERICAN CONSTITUTION?* (2d ed. 2003); and ROBERT A. DAHL, *ON POLITICAL EQUALITY* (2006) [hereinafter *ON POLITICAL EQUALITY*].

36. THOMAS CHRISTIANO, *THE CONSTITUTION OF EQUALITY: DEMOCRATIC AUTHORITY AND ITS LIMITS* 12 (2008) [hereinafter *CONSTITUTION OF EQUALITY*].

37. See, e.g., John Dewey, *Democracy and Educational Administration*, in *INTELLIGENCE IN THE MODERN WORLD: JOHN DEWEY’S PHILOSOPHY* 400 (1939).

38. *DEMOCRACY AND ITS CRITICS*, *supra* note 35, at 126–27.

39. *CONSTITUTION OF EQUALITY*, *supra* note 36, at 46.

40. *Id.* at 51.

lic.”<sup>41</sup> In effect, the only way we can each know that we are getting equal respect in our polity is if that equality is public. The state itself is the most important institution in establishing this public reality.<sup>42</sup>

The implications for the tax system of PVE and publicity mean that to be politically just, a tax system both should not harm PVE and should not be perceived to harm PVE. The premise of this Article, then, is that our tax policy ought not be designed in a way that hurts democratic functioning. A further premise is that we could design tax policy to improve that functioning. Finally, it is important that the tax system not be seen to harm PVE.

Of course, large states cannot possibly meet the requirements of pure democracy and thus theorists within the democratic tradition must work on theories of polyarchy—the rule of the many—instead. This has consequences for how we ought to think about realistic political justice.

The next Section thus reviews efforts to derive a democratic order workable in a plural world. First, I consider the elements Dahl suggests are necessary for a state to function well as a democratic order. Additionally, I consider three models of democracy: republican, liberal, and deliberative. These systems of democratic thought detail how such democratic values and arrangements might apply to substantive tax policy. I focus on the role of civil society in each of these traditions in the Section below.

### B. *Three Democratic Traditions*

Once a group has achieved some size, ideal democracy becomes impossible. In order to be democratic in nature, political theorists have determined that a polyarchy must adopt certain principles.<sup>43</sup> It must allow the election of representatives of the people on a frequent basis.<sup>44</sup> There must be freedom of speech to discuss matters of importance to the political system.<sup>45</sup> Institutions outside of the government must provide robust information regarding the decisions before the government.<sup>46</sup> There should be no hindrance on the formation of associations, particularly of political variety, and all individuals should have each of these freedoms.<sup>47</sup> Dahl lists seven specific institutions that are critical to a well-functioning polyarchy: (1) elected officials; (2) free and fair elections; (3) inclusive suffrage; (4) right to run for

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41. Immanuel Kant, *Perpetual Peace: A Philosophical Sketch*, in KANT: POLITICAL WRITINGS 126 (Hans Reiss ed., Nisbet trans., 1971).

42. CONSTITUTION OF EQUALITY, *supra* note 36, at 53.

43. See DEMOCRACY AND ITS CRITICS, *supra* note 35, at 221–22.

44. *Id.* at 221.

45. *Id.*

46. *Id.*

47. *Id.*

office; (5) freedom of expression; (6) alternative information; and (7) associational autonomy.<sup>48</sup>

These principles alone do not ensure a just practical democratic political system. We can get deeper into this question of what a just democratic system might look like, though, by looking at a number of democratic political traditions. As noted above, I focus on three primary traditions:<sup>49</sup> liberal, republican, and deliberative democracy. These traditions order society a bit differently and prioritize different values. But they also espouse common principles that can guide the formation of tax policy: the importance of recognizing the equal rights of citizens, the promotion of freedoms of speech and association, and the deep importance of civil society in protecting these rights.

Liberal and republican theories pursue distinctly different perspectives.<sup>50</sup> The liberal theory comes from the perspective of the individual, while the republican pursues that of the universal.<sup>51</sup> An individual perspective prioritizes individual rights and thus builds political protections for individual freedom.<sup>52</sup> For instance, the United States Bill of Rights emphasizes individual freedoms.<sup>53</sup> A universal perspective prioritizes the group instead of the individual.<sup>54</sup> The French people, for instance, prioritize the state in making decisions for the entirety of the country.<sup>55</sup> The procedural or deliberative democratic theories try to marry those two perspectives.<sup>56</sup> These seek to give honor to both the individual and the state through reasoned, structured dialogue to generate a consensus will.<sup>57</sup>

These democratic traditions all struggle with a major challenge: the members of a political society fulfill two roles—that of maker of government and its matter.<sup>58</sup> Individuals are both the agents and the ob-

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48. *Id.*

49. Jürgen Habermas, *Three Normative Models of Democracy*, in THE INCLUSION OF THE OTHER 239, 239 (Ciaran Cronin & Pablo De Greiff eds., 1998) [hereinafter INCLUSION OF THE OTHER]. Robert Dahl also works generally from these traditions in DEMOCRACY AND ITS CRITICS, *supra* note 35, at 224–33. There are many strains of democratic theory and different ways to describe them. *See, e.g.*, Jud Mathews, *Minimally Democratic Administrative Law*, 68 ADMIN. L. REV. 605, 613, 635 (2016) [hereinafter *Minimally Democratic*] (describing three American democratic traditions of pluralist, civic republican, and presidentialist that have been influential on our U.S. administrative law, while introducing the idea of democratic minimalism to administrative law).

50. *See* INCLUSION OF THE OTHER, *supra* note 49, at 239–40.

51. *See id.* at 240–41.

52. *See id.* at 241.

53. *See* U. S. CONST. amend. I–X.

54. *See id.*

55. *Id.* at 115.

56. *Id.* at 246.

57. *Id.* at 248.

58. THOMAS HOBBS, *LEVIATHAN* 247 (Oxford Univ. Press 2d ed. 1929) [hereinafter *LEVIATHAN*]. *See also* JÜRGEN HABERMAS, *BETWEEN FACTS AND NORMS*, 448 (William Rehg trans., 1996) [hereinafter *BETWEEN FACTS*] (discussing modern law's

jects of government.<sup>59</sup> Thus, an individual and an association are always conflicted.<sup>60</sup> The individual has the right to make the laws, but the association will often make laws that are in conflict with certain individual beliefs.<sup>61</sup>

The liberal-democratic theorist prioritizes protecting individual rights in that conflict.<sup>62</sup> Liberal theory, centered on the work of John Locke, emphasizes private property rights.<sup>63</sup> The state is a mechanism to protect individual rights within a market frame-of-mind.<sup>64</sup> In the liberal-democratic view, a citizen's "voting decisions have the same structure as the acts of choice made by participants in a market."<sup>65</sup> Still, a liberal-democratic theorist supports political equality as an instrumental way to protect an individual's right to self-determination.<sup>66</sup>

The liberal model values civil society associations to bring citizen political voice to the legislature.<sup>67</sup> But, the liberal model views associations in a market model.<sup>68</sup> John R. Wright, for instance, argues interest groups bring important information to the legislature to allow it to make better policies and laws.<sup>69</sup> The liberal model is therefore often referred to as a pressure-group model.<sup>70</sup> Liberal theorists argue that pressure groups ought to be diverse and balanced so that the legislature is best able to find the most supported ideas.<sup>71</sup> Additionally, liberal theorists promote the idea that civil society might provide goods to a minority population that are different from those that are provided by the majoritarian state.<sup>72</sup> Civil society provides a place to allow experimentation.

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Janus-faced nature where its addressees can see law as a command or view it as part of living a well-ordered life).

59. See LEVIATHAN, *supra* note 57.

60. See *id.*

61. See *id.* at 247, 251.

62. Frank Michelman, *Political Truth and the Rule of Law*, 8 TEL AVIV U. STUD. L., 281, 283 (1988) [hereinafter *Political Truth*].

63. *Id.*

64. *Id.*

65. *Three Normative Models*, *supra* note 13, at 3.

66. See *id.* at 2.

67. Elizabeth S. Clemens, *The Constitution of Citizens: Political Theories of Nonprofit Organizations*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 207, 208 (Walter W. Powell & Richard Steinberg eds., Yale Univ. Press 2d ed. 2006).

68. *Id.* at 207.

69. JOHN R. WRIGHT, INTEREST GROUPS AND CONGRESS 174 (2003).

70. See RULE OF THE MANY, *supra* note 32, at 251 (1996).

71. See *id.* (citing first Joshua Cohen & Joel Rogers, *Secondary Associations and Democratic Governance*, 20 POL. & SOC'Y 393, 424 (1992), and then citing HANNAH PITKIN, THE CONCEPT OF REPRESENTATION 142 (1967) [hereinafter CONCEPT OF REPRESENTATION]).

72. James Douglas, *Political Theories of Nonprofit Organization*, in THE NON-PROFIT SECTOR: A RESEARCH HANDBOOK 43, 47 (Walter W. Powell ed., 1987).

For the republican view, individuals obtain their highest achievement through collectively governing themselves at the state level.<sup>73</sup> While republican theorists support a representative democracy, they neither support it for equality's sake, nor because they explicitly support the right to democratic participation.<sup>74</sup> Instead, the republican theorist believes the individual finds virtue and freedom in a cooperative endeavor with the state.<sup>75</sup> "[G]overnment should rest on wisdom and not on will; the good of the nation emerges not from a general will but from 'the general reason of the whole.'"<sup>76</sup>

Republican theory supports the primacy of the equality of the people of the community.<sup>77</sup> This common will is typically anchored in a cultural or religious tradition that provides substantial presuppositions for the proper order of the state.<sup>78</sup> The republican theorist fears the corruption of the government by faction.<sup>79</sup> By *faction*, I mean groups representing selfish interests of citizens against the common interests of all the people of the state.<sup>80</sup> In the older republican traditions, the theorists argued the defense against factions lay in aristocratic governance with some power shared with the many, such as the British House of Commons.<sup>81</sup> In the modern thread of republicanism, the defense against faction involves the separation of powers as recommended by Montesquieu.<sup>82</sup>

All the same, republican theorists recognize associations within the state and civil society as critical to a just political order.<sup>83</sup> As republicans began to accept the idea of a representational democracy, and as the state increased in size and diversity, republican theorists began to also accept the importance of groups to represent individual interests.<sup>84</sup> Some republican advocates like Philip Pettit argue that

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73. INCLUSION OF THE OTHER, *supra* note 49, at 247. *See also Political Truth*, *supra* note 62, at 284.

74. PHILIP PETTIT, *REPUBLICANISM: A THEORY OF FREEDOM AND GOVERNMENT* 8 (1997) [hereinafter *FREEDOM AND GOVERNMENT*].

75. *Id.*

76. CONCEPT OF REPRESENTATION, *supra* note 71, at 169 (citing Samuel H. Beer, *The Representation of Interests in British Government: Historical Background*, 51 AM. POL. SCI. REV. 613, 616 (1957) (trying to encapsulate the thought of Edmund Burke)).

77. *See Three Normative Models*, *supra* note 13, at 2; *see also* DAVID HELD, *MODELS OF DEMOCRACY* 47 (3d ed. 2006) [hereinafter *MODELS OF DEMOCRACY*]; *DEMOCRACY AND ITS CRITICS*, *supra* note 35, at 25.

78. *See Three Normative Models*, *supra* note 13, at 2.

79. *See THE FEDERALIST* NO. 10, at 47 (James Madison) (Ian Shapiro ed., 2009).

80. *See id.* at 48.

81. *See THE FEDERALIST* NO. 47, at 245–46 (James Madison) (Ian Shapiro ed., 2009); *see also DEMOCRACY AND ITS CRITICS*, *supra* note 35, at 25; Atkinson, *supra* note 7, at 246–47. Obviously, Madison in *The Federalist Papers* talked about the concern of faction. He recommended a large government with a separation of powers to ensure against this form of corruption.

82. *See THE FEDERALIST* NO. 47, *supra* note 81, at 245–46.

83. *DEMOCRACY AND ITS CRITICS*, *supra* note 35, at 30.

84. *Id.*



nondomination by the state is an important value and believe civil society is critical to preventing this type of domination.<sup>85</sup>

Others find the republican and liberal theories problematic. Jane Mansbridge, for example, sees the liberal and republican models as dead ends of adversary democracy, solely based on self-interest.<sup>86</sup> This is Hobbes's model of politics where humans pursue "[p]ower after power, that ceaseth [only] in [d]eath,"<sup>87</sup> and deliberative democracy was born in this space.<sup>88</sup> There are many versions of deliberative democracy, but I rely primarily upon the views of Jürgen Habermas's discourse theory to present that case.<sup>89</sup> Though he draws from republican and liberal theories, he rejects both as failing to provide a just system.

Two facts significantly inform Habermas's theory: the plurality of today's world and the governance disaster of World War II. By plurality of today's world, I mean a society that is divided along "segmental cleavages."<sup>90</sup> "This exists where political divisions follow very closely, and especially concern lines of objective social differentiation."<sup>91</sup> The consequence of this plural world is a lack of one unifying cultural belief, such as a common religion, to provide a common base upon which to construct our governance. This leads Habermas to anchor just governance in a community operating with a shared concept of communicative action.<sup>92</sup> The lesson from World War II for Habermas is the potential of the state to destroy the individual. This latter fact means that it is important to build safeguards for individuals from state domination.

Deliberative democracy calls on us to hold "a multi-perspectival mode of forming, defending, and thereby refining our preferences."<sup>93</sup> A successful and politically just system in this tradition "depends not on a collectively acting citizenry but on the institutionalization of the corresponding procedures and conditions of communication, as well

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85. FREEDOM AND GOVERNMENT, *supra* note 74, at 148. This notion of non-domination is seen in legal scholarship as well. Jud Mathews, for instance, argues for a democratic minimalism to guide administrative law in part on the claim that political systems should at least be "built around the concept of non-domination—in essence, the idea that people should not be vulnerable in their basic interests to arbitrary or unfair exercises of power." *Minimally Democratic*, *supra* note 49, at 635.

86. MANSBRIDGE, *supra* note 28, at 17.

87. LEVIATHAN, *supra* note 58, at 75.

88. See BETWEEN FACTS, *supra* note 58, at 287–328.

89. *Id.* at 169–70.

90. AREND LIJPHART, DEMOCRACY IN PLURAL SOCIETIES 3 (1977).

91. *Id.* (citing HARRY ECKSTEIN, DIVISION AND COHESION IN DEMOCRACY: A STUDY OF NORWAY 34 (1966)).

92. See BETWEEN FACTS, *supra* note 58, at 3–6.

93. C. Offe & U. Preuss, *Democratic Institutions and Moral Resources*, in POLITICAL THEORY TODAY 169 (David Held ed., 1991).

as on the interplay of institutionalized deliberative processes with informally developed public opinions.”<sup>94</sup>

Habermas’s discourse theory is different from republican theory because it is decentered from the state.<sup>95</sup> While the general will is determined by deliberative processes at the level of the state, like in a republican model, that general will is more deeply informed by an informal public will developed at the level of civil society. Additionally, Habermas prioritizes a constitution in his discourse theory to institutionalize the process of communication leading to the formation of the general will.<sup>96</sup> The theory differs from liberalism because it does not employ constitutional norms to regulate a market mechanism, and it envisions a civil society separate from both the state and economic power.<sup>97</sup>

Deliberative democracy depends upon two spheres of communicative action.<sup>98</sup> Habermas’s communicative action provides that individuals have the capability to use their language to communicate with others, verify claims, and take group-oriented action based upon that communication.<sup>99</sup> Habermas argues there needs be one sphere of communicative action at the legislative/administrative level that includes the branches of government and political parties that engage in discursive rationalization to create law, and another as an autonomous public sphere anchored by civil society.<sup>100</sup> The public sphere/civil society is a separate space from the economic and the administrative and must be strong enough to maintain its own both against money and the administrative state.<sup>101</sup>

The public sphere includes conversations in taverns and on the streets, at rock concerts in theaters, and gatherings at churches, and also isolated individuals digesting media on their own.<sup>102</sup> That public sphere needs be open and inclusive. It cannot harden into an organization, and it must have “unrestricted inclusion.”<sup>103</sup> The public sphere develops informal, constructed opinions that are to be delivered through a “sluice” to the administrative structure.<sup>104</sup> That public sphere needs “sufficiently inclusive participation” but its success relies more upon “the formal criteria governing how a qualified public opin-

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94. BETWEEN FACTS, *supra* note 58, at 298.

95. *Id.*

96. *Id.*

97. *Id.* at 298–99.

98. *Id.*

99. *Id.*

100. *See id.* at 171, 299, 371–73.

101. INCLUSION OF THE OTHER, *supra* note 49, at 249.

102. BETWEEN FACTS, *supra* note 58, at 374.

103. *Id.*

104. *Cf.* CONSTITUTION OF EQUALITY, *supra* note 36, at 196 (questioning the reasonableness of this assumption of Habermas that political will formation is likely to happen).

ion comes about.”<sup>105</sup> In Habermas’s vision of the public sphere, formal criteria demands participants take a second-person attitude and grant communicative freedom to the other in a “linguistically constituted public space.”<sup>106</sup> An energetic civil society is needed to protect liberal rights such as freedom of speech, association, assembly, press, and also the integrity and freedom of private life spheres.<sup>107</sup>

Critics of Habermas’s vision of deliberative democracy argue that his focus on procedure alone is a failure. Though he recognizes the inequality of citizen resources, he fails to advocate for a system that requires an equality of resources, and that failure will lead to a failure of democratic rights for all.<sup>108</sup> Regarding the matter of a welfare state and the relation between material and legal equality, Habermas states that “[i]f private and public autonomy are co-original, then this relation can, in the final analysis, be specified only by the citizens themselves.”<sup>109</sup> In the end, Habermas believes justice is found primarily in a just democratic procedure, not in some allocation of resources.<sup>110</sup>

To summarize, each tradition generally upholds distinctly democratic traditions but each anchors justice in different institutional structures. Though adherents of each would disagree on much, each also finds there is an importance in recognizing the equal rights of citizens, the promotion of freedoms of speech and association, and the deep importance of civil society in protecting these rights.

### C. *How Does Democratic Justice Apply to Income Tax?*

On its face, it might not appear that the income tax impacts political justice as it relates to a fair democratic process. We all might agree that the way a tax is enacted impacts political voice, and that IRS interpretation of a Code section in regulations impacts political voice,<sup>111</sup>

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105. BETWEEN FACTS, *supra* note 58, at 362.

106. *Id.* at 361.

107. *Id.* at 368.

108. William Scheuerman, *Between Radicalism and Resignation: Democratic Theory in Habermas’s Between Facts and Norms*, in HABERMAS: A CRITICAL READER 162–63 (Peter Dews ed., 1999).

109. BETWEEN FACTS, *supra* note 58, at 414.

110. *See id.* at 414–15.

111. There is deep scholarship in administrative law, much of which is focused on whether unelected bureaucrats of agencies are violating democratic principles when they engage in both rule writing and enforcement. *See, e.g., Minimally Democratic*, *supra* note 49, and the literature discussed therein. *See also* Joshua Galperin, *The Life of Administrative Democracy*, 108 GEO. L.J. 1213, 1215 (2020) (discussing the democratic literature of agencies in light of an agency, the United States Department of Agriculture’s farmer committee system, which elects its representatives). Tax law scholars have considered this question as well. *See, e.g., Kristen E. Hickman, The Need for Mead: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1549 (2006) (discussing *Chevron* deference to IRS regulations as in part a matter of democratic accountability); James Puckett, *Structural Tax Exceptionalism*, 49 GA. L. REV. 1067, 1072 (2015) (discussing tax exceptionalism and judicial deference to the IRS in its rulemaking activities and the reality that combining “prospective

but it is likely more difficult to see why democratic justice would apply to the substance of tax law. Could the tax law have an impact on procedural aspects of democracy? I think so.

Accounting for income from a maker of widgets based on widgets sold and allowing a deduction for a basic business expense like paying the salaries of an employee who is making widgets may not seem to impact political voice equality. Nor would political voice seem to be playing a role in the tax burden Joe or Mary faced from their \$40,000 or \$100,000 salary.

Nevertheless, as some have argued, the choice to employ a progressive income tax speaks to democratic justice in that it affects economic inequality in a political system.<sup>112</sup> Because those with greater resources have a greater ability to impact government decisions, a progressive income tax *might* limit (or increase) disparities in political voice.<sup>113</sup> James Repetti argues that the question of whether to utilize a progressive income tax is informed by a need to maintain equality of opportunity.<sup>114</sup>

How would we determine whether a Code section implicated political justice in a negative way? Considering the different democratic traditions discussed above, each evinces an interest in some PVE and the importance of the citizens as a body determining what the group is going to do. Each of the democratic traditions sees civil society organizations as important in ensuring political voice and ensuring civil rights, like freedom of speech and association, in constructing a just political society. Thus, an aspect of the tax law, its procedures, or its enforcement that impacts these types of arrangements should be candidates for Code sections that might impact political justice in a negative way.

Critical tax scholars have marshaled evidence to show the Code's structure often applies in ways that negatively impact certain groups based on gender, race, or sexual orientation.<sup>115</sup> This is a political justice critique. By excluding the voices of individuals from these groups, we as a country are not providing equal political voice in shaping the laws in a very visible way. This makes a statement about the value of the voice of these individuals to the country and simultaneously reinforces that value.

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rulemaking, enforcement, and retroactive adjudicatory powers under one umbrella. . . . presents a potential for an agency to overreach or abuse power").

112. See *Democracy and Opportunity*, *supra* note 4, at 1154.

113. *Id.*

114. *Id.*

115. See, e.g., Beverly I. Moran & William Whitford, *A Black Critique of the Internal Revenue Code*, 1996 WIS. L. REV. 751 (1996) (arguing that the choices made in the Code systematically exclude the voices of black citizens from shaping the policies in the Code); CRITICAL TAX THEORY: AN INTRODUCTION (Anthony C. Infanti & Bridget J. Crawford eds, 2009).

With respect to individual Code sections, if, for instance, there was a tax on the act of voting, we could clearly see an impact on political justice at the Code level. In the income tax, we tax income, so it might be a little harder to directly see such a clear procedural democracy question. Nevertheless, in the income tax, we try to cast a wide net so that the tax burden is spread across all activity. This also limits opportunities for avoiding the income tax. We also tax every conceivable entity that might generate income such as corporations, partnerships, and trusts. While Congress tries to cast that net widely, it removes certain income generating activity,<sup>116</sup> and certain types of entities, from taxation.<sup>117</sup> It also lowers taxation based on deductions or credits for some activities.<sup>118</sup> It is in this space that I want to examine political justice.

We are used to thinking of the income tax in terms of the incentives it can provide. To the extent the income tax provides a deduction for an activity that impacts political voice, the tax is impacting popular will.<sup>119</sup> For instance, allowing a deduction for lobbying expenditures or for political campaign expenditures impacts political voice.<sup>120</sup> Also, to the extent we do not tax organizations engaged in political voice activities, we impact popular will.<sup>121</sup> In the case of the tax treatment of labor unions, I argued that we should consider the political voice impact of deductions and tax exemption.<sup>122</sup> Problematically, the benefit to the members of these organizations is of great use to wealthy members with access to expertise who face little in the way of collective action challenges, and of highly limited use to persons who suffer severe collective action challenges (such as the poor).<sup>123</sup>

In the analysis below, I consider these same political justice themes associated with advocacy organizations. But advocacy groups are only

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116. See, e.g., 26 U.S.C. § 115.

117. 26 U.S.C. § 501. Also, state and local political entities are in effect generally exempt from the income tax.

118. See Stanley S. Surrey, *Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance*, 84 HARV. L. REV. 352, 353–54 (1970) (discussing the idea of spending through the tax code as tax expenditures).

119. See *Prop Up the Heavenly*, *supra* note 7, at 367.

120. 26 U.S.C. § 162(e) (2018) (prohibiting such deductions).

121. 26 U.S.C. § 527 (2018) (providing tax exemption to political organizations, though § 527(e) applies a tax to net investment income of these same organizations). Also, we require an individual who transfers an appreciated asset to a political organization to recognize gain upon the contribution to the political organization. 26 U.S.C. § 84.

122. *Prop Up the Heavenly*, *supra* note 7 (arguing that Congress's choice to effectively stop labor union members from deducting union dues while allowing businessmen to deduct their dues was an unjust policy because it harmed the social choice function).

123. *Id.* at 340–41.

a small part of social welfare organizations.<sup>124</sup> For instance, over 70% of social welfare organization revenue is earned by health providers and insurers.<sup>125</sup> How might matters of political justice relate to the tax policy as applied to these varied groups?

While it might be easy to see that granting some interest groups a subsidy based on income helps politically active groups in an unjust, arbitrary manner, it might be harder to see the problem with granting benefits to an organization that is directly carrying out social welfare. I believe political justice ought to play a role in how we conceive of these provisions of collective goods. The next Section reviews the universe of social welfare organizations and the legal structure applied to this diverse group.

### III. SOCIAL WELFARE ORGANIZATION LEGAL REGIME

Social welfare organizations include “[c]ivic leagues or organizations not organized for profit but *operated exclusively for the promotion of social welfare* . . . and no part of the net earnings of which [entities] inures to the benefit of any private shareholder or individual.”<sup>126</sup> It is believed the policy originated out of a comment from the U.S. Chamber of Commerce when Congress was enacting the income tax.<sup>127</sup> The Chamber argued that certain organizations that perform “civic functions” should not pay tax.<sup>128</sup> Though it might have had noble intentions, the IRS itself has stated that: “section 501(c)(4) has been used by both the courts and the Service as a haven for organizations that lack the accepted essential characteristics of a taxable entity, but elude classification under other subparagraphs of 501(c).”<sup>129</sup>

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124. *Examining the Landscape*, *supra* note 9, at 347, 367 (discussing that only a relatively small part of the social welfare organization sector seems to be made up of advocacy or politically active organizations).

125. FROM CAMPS TO CAMPAIGN FUNDS, *supra* note 9, at 6.

126. 26 U.S.C. § 501(c)(4) (emphasis added). Treas. Reg. § 1.501(c)(4)-1(a)(1) (as amended in 1990), makes clear that either type of organization must be organized and operated not for profit and exclusively for the promotion of social welfare.

127. See James J. McGovern, *The Exemption Provisions of Subchapter F*, 29 TAX LAW. 523, 530 (1976).

128. See *Tariff Schedules of the Revenue Act of 1913: Hearing on H.R. 3321 Before the Subcomm. of the Comm. on Finance*, 63d Cong. 2001 (1913) (statement of United States Chamber of Commerce). For a closer look at the testimony including the status of prior law that spurred it, see Lloyd Hitoshi Mayer, *A (Partial) Defense of § 501(c)(4)’s “Catchall” Nature*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 439, 442–45 (2018) [hereinafter *A (Partial) Defense*].

129. I.R.S., *Social Welfare: What Does it Mean? How Much Private Benefit is Permissible? What is Community?*, 1981 EO CPE Text, <https://www.irs.gov/pub/irs-tege/eotopicg81.pdf> [https://perma.cc/8MR6-AJ7X].

A. *The Law Regarding Qualifying as a Social Welfare Organization*

A social welfare organization must operate *exclusively* for social welfare purposes and not allow its earnings inure to those who control the organization.<sup>130</sup> The Treasury Department interprets *exclusively* to mean “*primarily* engaged in promoting in some way the common good and general welfare of the people of the community.”<sup>131</sup> A social welfare organization must exhibit a primary purpose of “bringing about civic betterments and social improvements.”<sup>132</sup> The promotion of social welfare does not include participating or intervening in a political campaign.<sup>133</sup> It also does not include operating a social club or a for-profit business. Positive collective activity seems to qualify unless it supports too much of a private purpose.<sup>134</sup>

The largest complaint about the section is the vagueness of the standard.<sup>135</sup> Often, the IRS finds that an organization that did not meet the requirements of being charitable under section 501(c)(3) fits the requirements of a social welfare organization. For example, an organization that both assisted older men in finding jobs and educated employers about the benefits of hiring these older men, failed to qualify as a Section 501(c)(3) organization but qualified under Section 501(c)(4).<sup>136</sup> Similarly, an organization that established and maintained a legal facility to build and operate a stadium for a municipality was not charitable but did promote social welfare.<sup>137</sup>

In *Erie Endowment*, an organization failed to qualify because it did not demonstrate that it was “a community movement designed to accomplish community ends.”<sup>138</sup> However, in *Eden Hall*, the court held that operating a women’s home as a vacation spot primarily for women who worked for H. J. Heinz Company qualified for social welfare status.<sup>139</sup> The court further stated that an organization that focused on “one segment or slice of the community” met the standard.<sup>140</sup> The IRS announced it would not follow this decision.<sup>141</sup>

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130. Treas. Reg. § 1.501(c)(4)-1(a)(2) (as amended in 1990).

131. *Id.* (emphasis added).

132. *Id.*

133. *Id.*

134. *See id.*

135. *See, e.g., Examining the Landscape, supra* note 9, at 348 (referring to the vagueness of the standard as a “no man’s land,” though ultimately concluding it may serve a useful border boundary guarding purpose). *But cf. A (Partial) Defense, supra* note 128, at 445 (suggesting that Congress may very well have intended the broad standard as it has been applied by the IRS).

136. Rev. Rul. 57-297, 1957-2 C.B. 307.

137. Rev. Rul. 57-493, 1957-2 C.B. 314.

138. *Erie Endowment v. United States*, 316 F.2d 151, 156 (3d Cir. 1963).

139. *Eden Hall Farm v. United States*, 389 F. Supp. 858, 859, 866-68 (W.D. Pa. 1975).

140. *Id.* at 866.

141. Rev. Rul. 80-205, 1980-2 C.B. 184.

Marshalling resources in a nonprofit organization to solve a lack of adequate housing for low- and moderate-income groups satisfies the promotion of social welfare criteria.<sup>142</sup> Likewise, a city plan to eradicate unemployment qualifies as a social welfare organization.<sup>143</sup> To eradicate unemployment, corporations and other persons or entities contributed money.<sup>144</sup> The organization then loaned that contributed money to those who would operate the land.<sup>145</sup> The IRS said the organization was “operated primarily to bring about civic betterment and social improvement.”<sup>146</sup> An organization formed to supply water to residents of a particular community promoted social welfare because it used the profits to “raise the water table.”<sup>147</sup>

A community-operated bus service convinced the IRS it promoted social welfare because the services were available to all in the community.<sup>148</sup> However, the IRS acknowledged that the service was mostly used by the group’s founders.<sup>149</sup> The IRS similarly approved an organization that operated a rural airport after the FAA found there was a need for such a service, and the municipality provided the airport land to operate upon.<sup>150</sup>

The IRS recognized as exempt an organization formed to clean up spills in a city port.<sup>151</sup> Again, the service was available to everyone in the port.<sup>152</sup> In contrast, the organization in *Contracting Plumbers* was found not to promote social welfare<sup>153</sup> because the group only repaired potholes caused by plumbers who were members of the organization.<sup>154</sup> An organization that transmitted television signals only to members was found to not be operated primarily for social welfare,<sup>155</sup> while an organization that provided television signals to anyone in the area met the exemption requirements.<sup>156</sup>

The IRS determined that a credit counseling organization formed to assist individuals with financial problems qualified as a social welfare

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142. Rev. Rul. 55-439, 1955-2 C.B. 257.

143. Rev. Rul. 64-187, 1964-1 C.B. 187.

144. *Id.*

145. *Id.*

146. *Id.*

147. Rev. Rul. 66-148, 1966-1 C.B. 143.

148. Rev. Rul. 78-69, 1978-1 C.B. 156.

149. *Id.*

150. Rev. Rul. 78-429, 1978-2 C.B. 178.

151. Rev. Rul. 79-316, 1979-2 C.B. 228.

152. *Id.*

153. *Contracting Plumbers Coop. Restoration Corp. v. United States*, 488 F.2d 684, 687 (2d Cir. 1973).

154. *Id.* at 685, 687.

155. Rev. Rul. 54-394, 1954-2 C.B. 131.

156. Rev. Rul. 62-167, 1962-2 C.B. 142. *But cf.* Rev. Rul. 55-716, 1955-2 C.B. 263 (stating that “[a]n organization formed for the purpose of furnishing television antenna service to its members is not entitled to exemption from Federal income tax” under any provision of law).



organization.<sup>157</sup> Congress later became concerned about the abusive use of this classification and passed new rules to constrain credit counseling organizations.<sup>158</sup>

Groups organized to engage in pastimes often qualify as social welfare organizations. A gun range that sold annual memberships and ran gun safety courses was determined to be exempt.<sup>159</sup> Similarly, the IRS found that a roller-skating rink operating at reasonable charge to all in the community promoted social welfare.<sup>160</sup>

A series of rulings found that beautification of a city or city areas can qualify as a social welfare purpose. The IRS determined a neighborhood association to be exempt under Section 501(c)(4) for providing security patrols with membership dues.<sup>161</sup> In that ruling, anyone could become a member, and members and nonmembers alike had access to those community goods and services provided by the organization.<sup>162</sup> The IRS denies status to organizations where residents must pay money in exchange for beautification or security.<sup>163</sup> However, the IRS determined a group formed to help out businesses and residents of one city block promoted social welfare.<sup>164</sup>

Health insurance-related organizations make up the largest amount of revenue associated with social welfare organizations.<sup>165</sup> This is odd, as in the Tax Reform Act of 1986, Congress eliminated commercial insurance organizations such as Blue Cross Blue Shield from qualifying as exempt from the corporate income tax.<sup>166</sup> Many of the Blue Cross organizations were organized under section 501(c)(4) themselves.<sup>167</sup> An IRS Continuing Professional Education ("CPE") text from 1981 may provide some clues. In that text, the IRS acknowledged that it has long held certain prepaid medical plans meet the exemption requirements of a social welfare organization, in spite of the fact that the IRS has a policy against mutual benefit associations

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157. Rev. Rul. 65-299, 1965-2 C.B. 165.

158. 26 U.S.C. § 501(q).

159. Rev. Rul. 66-273, 1966-2 C.B. 222.

160. Rev. Rul. 67-109, 1967-1 C.B. 136.

161. Rev. Rul. 75-386, 1975-2 C.B. 211.

162. *Id.*

163. Rev. Rul. 77-273, 1977-2 C.B. 195.

164. Rev. Rul. 75-286, 1975-2 C.B. 210.

165. FROM CAMPS TO CAMPAIGN FUNDS, *supra* note 9, at 6 (representing that health providers and insurers earned almost \$63 billion of the \$86 billion of revenue earned by social welfare organizations, according to the 2014 IRS Business Master file).

166. See 26 U.S.C. § 501(m).

167. William M. Miller, Phyllis D. Haney & Kenneth J. Earnest, *Insurance: The Rule of '86*, 1997 EO CPE Text 215, 216, <https://www.irs.gov/pub/irs-tege/eotopicn97.pdf> [<https://perma.cc/475K-AHFA>].

so qualifying.<sup>168</sup> The IRS published this CPE before the enactment of section 501(m).<sup>169</sup>

There is little guidance from the IRS on when an HMO qualifies as a social welfare organization.<sup>170</sup> An IRS audit technique guide simply restates the basic requirements of operating as a social welfare organization in discussing HMOs.<sup>171</sup>

An HMO that served “underserved” members of the community furthered social welfare.<sup>172</sup> Organizations called individual practice associations (“IPA”) established pursuant to federal policy associated with HMOs, however, are not operated exclusively for social welfare purposes.<sup>173</sup> IPAs are entities that are made up of doctors’ practices that establish compensation arrangements with an HMO and that share various expenses such as technological and administrative.<sup>174</sup> A court in 2008 found that an organization formed to provide vision insurance for members was not organized and operated exclusively for social welfare purposes because it operated primarily for its members rather than “the general welfare of the community.”<sup>175</sup>

Social welfare organizations can engage in lobbying activities as a social welfare purpose.<sup>176</sup> Lobbying is the activity of trying to persuade a public representative body to vote for or against a decision that is before that body.<sup>177</sup> The IRS has found that lobbying for animal rights<sup>178</sup> and for the rights of the unborn<sup>179</sup> are both social welfare purposes. However, the IRS found that an organization engaged in civil disobedience was engaged in activities “contrary to the common good and the general welfare of the people in a community and thus are not permissible means of promoting the social welfare.”<sup>180</sup>

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168. I.R.S., *supra* note 129.

169. Congress amended 26 U.S.C. § 501 to include (m) in 1988. *See* 26 U.S.C. § 501.

170. That which is out there mostly would suggest that these organizations do not so qualify. *See, e.g.*, Rev. Rul. 75-199, 1975-1 C.B. 160 (explaining that an organization that paid sick and death benefits to members only did not qualify as a social welfare organization).

171. I.R.S., *Audit Technique Guide – Health Maintenance Organizations*, IRS.GOV, [https://www.irs.gov/pub/irs-tege/atg\\_hmo.pdf](https://www.irs.gov/pub/irs-tege/atg_hmo.pdf) [<https://perma.cc/YHL4-ZZP7>].

172. I.R.S. Gen. Couns. Mem. 39829 (Sept. 10, 1990).

173. Rev. Rul. 86-98, 1986-2 C.B. 74.

174. Health Maintenance Organization Act of 1973, 42 U.S.C.A. § 300e-1(5) (West 2011).

175. *Vision Serv. Plan, Inc. v. United States*, 265 F. App’x 650, 652 (9th Cir. 2008).

176. Rev. Rul. 68-656, 1968-2 C.B. 216.

177. *See* 26 U.S.C. § 501(c)(3) (stating “no substantial part of [its] activities . . . is carrying on propaganda, or otherwise attempting, to influence legislation” and the regulations thereunder Treas. Reg. 26 U.S.C. § 1.501(c)(3)-1(c)(3)); *see also* 26 U.S.C. 501(h)(2) and § 4911(d).

178. Rev. Rul. 67-293, 1967-2 C.B. 185.

179. Rev. Rul. 76-81, 1976-1 C.B. 156.

180. Rev. Rul. 75-384, 1975-2 C.B. 204. *See also* *Bob Jones Univ. v. United States*, 461 U.S. 574, 591–92 (1983). *See generally* Philip Hackney, *A Response to Professor Leff’s Tax Planning “Olive Branch” for Marijuana Dealers*, 99 IOWA L. REV. BULL.

While lobbying activity furthers a social welfare purpose, intervening in political campaigns does not.<sup>181</sup> Intervening in a campaign means to encourage people to vote for or against candidates for public office.<sup>182</sup> An organization that ranked candidates as its primary activity failed to show it was operated for a social welfare purpose because it provided the ranking to intervene in a campaign.<sup>183</sup> However, an organization can intervene in a political campaign and still qualify as a social welfare organization as long as it otherwise operates *primarily* as a social welfare organization.<sup>184</sup>

While it is not clear how much political intervention is too much, the IRS seems to operate on the basis that activities or revenue exceeding 50% of a social welfare organization's total activities or revenue is too much.<sup>185</sup> There are many who argue that the term "exclusively" found in the statute should be read to allow much less political activity.<sup>186</sup> Others, like the Bright Lines Project, argue that there is a lack of clarity in the qualitative activities that are considered political intervention and recommend the IRS adopt clearer rules on what is political intervention.<sup>187</sup>

Notably, Congress prohibits a taxpayer from deducting lobbying or political campaign expenses.<sup>188</sup> Until 1962, Treasury regulations prohibited the deduction of lobbying expenses, and the Supreme Court upheld this limitation in *Cammarano v. United States*.<sup>189</sup> In 1962, Congress permitted the deduction of lobbying expenses on issues germane to the taxpayer.<sup>190</sup> Nevertheless, in 1993, the Clinton administration

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25 (2014) (discussing the public policy doctrine as it relates to social welfare organizations).

181. Treas. Reg. § 1.501(c)(4)-1(a)(2)(ii) (as amended in 1990).

182. Rev. Rul. 67-368, 1967-2 C.B. 194.

183. *Id.*

184. Rev. Rul. 81-95, 1981-1 C.B. 332. See, e.g., Robert Maguire, *How Crossroads GPS Beat the IRS and Became a Social Welfare Group*, OPENSECRETS NEWS (Feb. 12, 2016, 11:42 AM), <https://www.opensecrets.org/news/2016/02/how-crossroads-gps-beat-the-irs-and-became-a-social-welfare-group/> [<https://perma.cc/R3KX-83TR>] (describing the battle with the IRS and whether Crossroads was operated primarily for a social welfare purpose).

185. *Examining the Landscape*, *supra* note 9, at 347. The IRS has never defined the limits. See Ellen P. Aprill, *A Case Study of Legislation vs. Regulation: Defining Political Campaign Intervention under Federal Tax Law*, 63 DUKE L.J. 1635, 1636-37 (2014).

186. See, e.g., Ellen P. Aprill, *The IRS's Tea Party Tax Row: How 'Exclusively' Became 'Primarily'*, PAC. STANDARD (June 7, 2013, 8:00 AM), <http://www.psmag.com/politics/the-irss-tea-party-tax-row-how-exclusively-became-primarily-59451/> [<https://perma.cc/K6KP-J5S9>].

187. Drafting Committee Explanation, Interim Draft, *The Bright Lines Project: Clarifying IRS Rules on Political Intervention*, PUBLICCITIZEN (May 8, 2014), [https://www.citizen.org/wp-content/uploads/migration/may\\_8\\_explanation\\_with\\_exhibit.pdf](https://www.citizen.org/wp-content/uploads/migration/may_8_explanation_with_exhibit.pdf) [<https://perma.cc/8G8B-5AGF>].

188. 26 U.S.C. § 162(e).

189. *Cammarano v. United States*, 358 U.S. 498 (1959).

190. 26 U.S.C. § 162(e).

successfully advocated for Congress to pass a law to again prohibit the deduction of these expenses.<sup>191</sup>

The current vague status of the social welfare standard demonstrated above seems to have been a big driver in the Tea Party crisis that arose in 2013.<sup>192</sup> There, many accused the IRS of “targeting” political organizations seeking to qualify as social welfare organizations.<sup>193</sup> It appears that the IRS simply did not know how to determine if an organization was intervening in a campaign and how much intervention was too much.<sup>194</sup>

Where an organization primarily engages in influencing elections, it is then considered for tax purposes as an organization described in section 527.<sup>195</sup> Such an organization still maintains a tax exempt status but is subject to a tax on investment income.<sup>196</sup> Unlike social welfare organizations, section 527 organizations must publicly disclose their donors.<sup>197</sup> Social welfare organizations that conduct too much political campaign activity are political organizations under section 527.<sup>198</sup> The IRS has provided guidance as to when certain activity is considered an exempt function activity under section 527 for social welfare organizations as well as business leagues and labor unions.<sup>199</sup> If an activity is categorized as exempt function activity, the organization comes under the tax under section 527(f). The IRS permits a social welfare organization to create a segregated fund to operate as a political organization under section 527 subject to certain notice and reporting requirements.<sup>200</sup>

The most intense political battle fought over social welfare organizations is whether they must disclose their donors.<sup>201</sup> Many refer to social welfare organizations as “dark money organizations” because they need not publicly disclose their donors even though they conduct

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191. Omnibus Budget Reconciliation Act (“OBRA”) § 13222, Pub. L. No. 103–66, 107 Stat. 312 (codified as amended in scattered sections of 26 U.S.C. (1993)).

192. Aprill, *supra* note 185.

193. See Philip Hackney, *Should the IRS Never “Target” Taxpayers? An Examination of the IRS Tea Party Affair*, 49 VAL. U. L. REV. 453, 453 (2015).

194. See *IRS Targeting of Applicants for Tax Exempt Status: Hearing Before the H. Comm. on Ways & Means*, 103d Cong. (2013) (statement of J. Russell George, Treas. Inspector Gen.).

195. 26 U.S.C. § 527.

196. 26 U.S.C. § 527(f).

197. Form 990, Return for Organization Exempt from Income Tax, Schedule B (2019), <https://www.irs.gov/pub/irs-pdf/f990.pdf> [<https://perma.cc/B6BS-FM7B>].

198. This can create real problems for a social welfare organization because a section 527 organization is supposed to file a notice with the IRS within twenty-four hours after its formation. 26 U.S.C. § 527(i).

199. Rev. Rul. 2004-6, 2004-1 C.B. 328.

200. *Id.*

201. See Roger Colinvaux, *Social Welfare and Political Organizations: Ending the Plague of Inconsistency*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 481 (2018) [hereinafter *Plague of Inconsistency*]. The IRS recently proposed regulations that would end the requirement that a social welfare organization disclose its donor names and addresses to the IRS.

politically related activity.<sup>202</sup> They generally need not disclose their donors to the Federal Election Commission, except when they engage in electioneering communications. Additionally, though the IRS used to require the disclosure of substantial donors to the IRS itself on Schedule B to the Form 990, in 2020, the Treasury Department promulgated regulations eliminating the requirement for social welfare organizations to disclose their donors.<sup>203</sup> I do not engage the question of whether social welfare organizations ought disclose their substantial donors in this Article.

B. *What Types of Organizations Make Up the Social Welfare Organization Community?*

A recent Urban Institute study paints a portrait of social welfare organizations.<sup>204</sup> As of 2012, the most numerous type of social welfare organization was community service clubs like Kiwanis and Rotary Club.<sup>205</sup> Despite representing 39% of social welfare organizations, the total revenue generated by community service clubs was a little over \$700 million—only 0.8% of the total revenue.<sup>206</sup> Health insurance and health providers were one of the smallest in number, making up only 0.6%, but possessing over 72.5% of the revenue at over \$62 billion.<sup>207</sup> Homeowner/neighborhood community groups made up about 9.2% with only about 2.8% of revenue.<sup>208</sup> Sports and recreation clubs made up about 10.1% in number and 3.9% in revenue at around \$3.4 billion.<sup>209</sup> A large group at 27% fit into a category of other.<sup>210</sup> Jeremy Khoulish suggests that advocacy organizations fit somewhere in this group.<sup>211</sup> That group held 12.5% of revenue at \$10.8 billion.<sup>212</sup>

What follows are some specific examples of types of social welfare organizations that I will return to again in Part IV. I first look at advocacy-related organizations. Then, I look at a health-related organization. Finally, I consider some specific clubs and homeowners' associations.

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202. *Id.* at 494.

203. TD 9898, 2020-25 I.R.B. 935.

204. FROM CAMPS TO CAMPAIGN FUNDS, *supra* note 9. See also *Examining the Landscape*, *supra* note 9, at 360–67 (unpacking the Koulsh study and discussing it in conjunction with data from IRS Data books).

205. FROM CAMPS TO CAMPAIGN FUNDS, *supra* note 9, at 6.

206. *Id.*

207. *Id.*

208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.*

## 1. Advocacy Social Welfare Organizations

The NRA, which earned over \$366 million in revenue in 2016 but lost nearly \$46 million, is a social welfare organization.<sup>213</sup> The ACLU, which earned over \$139 million in revenue in 2019 and lost almost \$7 million, is a social welfare organization, too.<sup>214</sup> The NRA states that it provides firearm safety, training, education and advocacy.<sup>215</sup> The ACLU states that it maintains and advances civil liberties such as those expressed in the First Amendment of the Constitution.<sup>216</sup> Finally, Karl Rove's organization, Crossroads GPS, qualifies as a social welfare organization as well—it earned \$16 million in revenue in 2016 and had almost \$500,000 in earnings.<sup>217</sup> It says it advocates for citizens on legislative issues that will shape our nation's future.<sup>218</sup> There are numerous large and powerful Democratic and Republican candidate-related organizations that are exempt as social welfare organizations as well.<sup>219</sup>

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213. Nat'l Rifle Ass'n of Am., Form 990: Return of Organization Exempt from Income Tax, pt. I, §§ 12, 19, at 1 (2016), [https://pp-990-rendered.s3.amazonaws.com/201722619349300507\\_full\\_0.html?X-Amz-Algorithm=AWS4-HMAC-SHA256&X-Amz-Credential=AKIA266MJEJYTM5WAG5Y%2F20200827%2Fus-east-1%2Fs3%2Faws4\\_request&X-Amz-Date=20200827T021129Z&X-Amz-Expires=1800&X-Amz-SignedHeaders=host&X-Amz-Signature=d78a3e5418dd09b849d064a783b91d9f80127cb78eab45a084c1f5a5f70150dc](https://pp-990-rendered.s3.amazonaws.com/201722619349300507_full_0.html?X-Amz-Algorithm=AWS4-HMAC-SHA256&X-Amz-Credential=AKIA266MJEJYTM5WAG5Y%2F20200827%2Fus-east-1%2Fs3%2Faws4_request&X-Amz-Date=20200827T021129Z&X-Amz-Expires=1800&X-Amz-SignedHeaders=host&X-Amz-Signature=d78a3e5418dd09b849d064a783b91d9f80127cb78eab45a084c1f5a5f70150dc) [https://perma.cc/Y7MT-9QF6].

214. See Am. Civil Liberties Union, PROPUBLICA: NONPROFIT EXPLORER, <https://projects.propublica.org/nonprofits/organizations/330325795> [https://perma.cc/8JL-FAGJ] (offering PDFs of the ACLU's Form 990s from 2005 to the present).

215. Nat'l Rifle Ass'n of Am., Form 990: Return of Organization Exempt from Income Tax, *supra* note 213, pt. I, § 1, at 1.

216. Am. Civil Liberties Union, Form 990: Return of Organization Exempt from Income Tax, *supra* note 214, pt. I, § 1, at 1.

217. Crossroads Grassroots Pol'y Strategies, Form 990: Return of Organization Exempt from Income Tax, pt. I, §§ 12, 19, at 1 (2016), [https://projects.propublica.org/nonprofits/display\\_990/272753378/12\\_2017\\_prefixes\\_27-30%2F272753378\\_201612\\_990O\\_2017121315023770](https://projects.propublica.org/nonprofits/display_990/272753378/12_2017_prefixes_27-30%2F272753378_201612_990O_2017121315023770) [https://perma.cc/4L58-E83R]. When I state *earnings*, I mean something akin to a profit in a nonprofit organization.

218. *Id.* pt. 3, § 1, at 2.

219. Many politicians, including 2016 presidential candidates Hillary Clinton and Donald Trump, have social welfare organizations that back their political efforts in some way. See, e.g., Ashley Balcerzak, *Inside Donald Trump's Army of Super PACs and MAGA Nonprofits*, CTR. FOR PUB. INTEGRITY (Feb. 18, 2019), <https://publicintegrity.org/politics/donald-trump-army-super-pacs-maga-nonprofits/> [https://perma.cc/EM2K-UMP8] (discussing an organization supporting Donald Trump named *America First Policies*); Dave Levinthal, *Inside Hillary Clinton's Big Money Calvary*, CTR. FOR PUB. INTEGRITY (Apr. 13, 2016, 11:10 AM), <https://publicintegrity.org/politics/inside-hillary-clintons-big-money-calvary/> [https://perma.cc/SS95-M2MR] (discussing an organization supporting Hillary Clinton named *American Bridge 21st Century Foundation*).

## 2. Health-Related Social Welfare Organizations

Delta Dental affiliates exist in all forty-nine states across the country.<sup>220</sup> They operate as nonprofit organizations that qualify as tax exempt social welfare organizations.<sup>221</sup> The largest, Delta Dental of California, generated over \$5.4 billion in revenue in 2018 and earned profits over \$171 million.<sup>222</sup> These organizations work to advance dental health through dental health benefits, technology, and support.<sup>223</sup> It is mystifying that Delta Dental continues to qualify under social welfare status because the IRS successfully revoked the tax exempt status of Vision Services affiliates around the country.<sup>224</sup> The primary reason Vision Services lost its status was because it operated almost exclusively to assist only its members rather than improving the community.<sup>225</sup> On its face, Delta Dental appears to do the same.

## 3. Service-Club Social Welfare Organizations

Kiwanis International, a social welfare organization, describes itself as “a global organization dedicated to improving the world one child and one community at a time.”<sup>226</sup> Kiwanis International appears to be the head of the Kiwanis clubs system.<sup>227</sup> It earned about \$18 million in revenue in the 2018 fiscal year, with about \$1 million in investment income.<sup>228</sup> Additionally, it incurred about \$18 million in expenses and

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220. *Delta Dental Member Companies and Operating States*, DELTA DENTAL, <https://www.deltadental.com/us/en/about-us/delta-dental-member-companies.html> [https://perma.cc/9DD9-UB9T].

221. *About Us*, DELTA DENTAL, <https://www.deltadental.com/us/en/about-us.html> [https://perma.cc/AY85-8VCE]; see, e.g., Delta Dental of Cal., PROPUBLICA: NONPROFIT EXPLORER, <https://projects.propublica.org/nonprofits/organizations/941461312> [https://perma.cc/N58C-8BE2]; Delta Dental of Wash., PROPUBLICA: NONPROFIT EXPLORER, <https://projects.propublica.org/nonprofits/organizations/910621480> [https://perma.cc/Q8Z7-ZM23]; Delta Dental Plan of Mich., PROPUBLICA: NONPROFIT EXPLORER, <https://projects.propublica.org/nonprofits/organizations/381791480> [https://perma.cc/YF86-TBSA]; Delta Dental Plan of Va., PROPUBLICA: NONPROFIT EXPLORER, <https://projects.propublica.org/nonprofits/organizations/540844477> [https://perma.cc/P7AS-Y6F8]; Delta Dental of Pa., PROPUBLICA: NONPROFIT EXPLORER, <https://projects.propublica.org/nonprofits/organizations/231667011> [https://perma.cc/Z3GW-NAFM].

222. Delta Dental of California, Form 990: Return of Organization Exempt from Income Tax, pt. I, §§ 12, 19, at 1 (2018), <https://projects.propublica.org/nonprofits/organizations/941461312/201903179349301005/full> [https://perma.cc/NK5A-9H6W].

223. *Id.* pt. 3, § 1, at 2.

224. *Vision Serv. Plan, Inc. v. United States*, 265 F. App'x 650, 652 (9th Cir. 2008).

225. *Id.* at 651.

226. Kiwanis Int'l Inc., Form 990: Return of Organization Exempt from Income Tax, pt. I, § 1, at 1 (2017), <https://pdf.guidestar.org/PDF/Images/2018/361/327/2018-361327510-11167682-9O.pdf> [https://perma.cc/W2DB-P44U].

227. See *The Structure of Kiwanis*, KIWANIS INT'L, <https://www.kiwanis.org/about/structure-of-kiwanis> [https://perma.cc/72N2-54Y3].

228. Kiwanis Int'l, Inc., Form 990: Return of Organization Exempt from Income Tax, pt. 1, §§ 10, 12, at 1 (2018), <https://pdf.guidestar.org/PDF/Images/2018/361/327/2018-361327510-11167682-9O.pdf> [https://perma.cc/G6KS-CBJ8].

held almost \$35 million in assets.<sup>229</sup> There are then a series of districts that make up Kiwanis International, such as the Cal-Nev-Ha District of Kiwanis International, which brought in about \$2.3 million in revenue and about \$2.3 million in expenses in the 2018 fiscal year.<sup>230</sup> Once you start getting into the club level, the revenue is typically under \$1 million a year.<sup>231</sup> GuideStar is also filled with charitable organizations of similar sizes associated with the districts and the clubs.<sup>232</sup> There are around 5,000 clubs and over 140,000 members in the United States according to Kiwanis.<sup>233</sup>

Rotary International is much larger—it brought in over \$106 million in revenue and about \$95 million in expenses in 2018.<sup>234</sup> It earned \$11 million in investment income and holds a total of \$172 million in assets.<sup>235</sup> Its mission is providing service to others, “and [it] advances world understanding, goodwill and peace through [its] fellowship of business, professional, and community leaders.”<sup>236</sup> It has very large associated charities, including the Rotary Foundation of Rotary International, which holds over \$1.25 billion in assets.<sup>237</sup> The clubs themselves appear to be relatively small businesses, like the Kiwanis clubs. Rotary reports over 337,000 members in the United States.<sup>238</sup>

#### 4. Homeowners’ Association Social Welfare Organizations

Though many homeowners’ associations are quite small, there are some large homeowners’ associations, such as the Association of Poinciana Villages, Inc.,<sup>239</sup> out of Kissimme, Florida and the Riverstone Homeowners Association out of Sugarland, Texas.<sup>240</sup> Poinciana earned about \$9.7 million in revenue and about \$9.2 million in ex-

229. *Id.*

230. Cal-Nev-Ha Dist. of Kiwanis Int’l, Form 990: Return of Organization Exempt from Income Tax, pt. 1, §§ 12, 18, at 1 (2018), [https://pdf.guidestar.org/PDF\\_Images/2018/940/359/2018-940359545-111d36ae-9O.pdf](https://pdf.guidestar.org/PDF_Images/2018/940/359/2018-940359545-111d36ae-9O.pdf) [<https://perma.cc/V2Q9-K3J8>].

231. *Id.*

232. GuideStar’s search function allows easy access to compare and contrast charitable organizations of various sizes. *Search*, GUIDE STAR, <https://www.guidestar.org/search> [<https://perma.cc/H7LX-KRBG>].

233. *Clubs*, KIWANIS INT’L, <https://www.kiwanis.org/clubs> [<https://perma.cc/U5UF-8RVU>].

234. Rotary Int’l, Form 990: Return of Organization Exempt from Income Tax, pt. 1, §§ 12, 18, at 1 (2018), [https://pdf.guidestar.org/PDF\\_Images/2018/361/707/2018-361707667-10766c95-9O.pdf](https://pdf.guidestar.org/PDF_Images/2018/361/707/2018-361707667-10766c95-9O.pdf) [<https://perma.cc/8Q4H-MPBU>].

235. *Id.* pt. 1, §§ 10, 20, at 1.

236. *Id.* pt. III, § 1, at 2.

237. Rotary Found. of Rotary Int’l, Form 990: Return of Organization Exempt from Income Tax, pt. 1, § 20, at 1 (2018), [https://pdf.guidestar.org/PDF\\_Images/2018/363/245/2018-363245072-10734d25-9.pdf](https://pdf.guidestar.org/PDF_Images/2018/363/245/2018-363245072-10734d25-9.pdf) [<https://perma.cc/8VX4-BSAB>].

238. *Rotary Clubs*, ROTARY INT’L, <https://www.rotary.org/en/get-involved/rotary-clubs> [<https://perma.cc/7N5H-CPE5>].

239. *See Association of Poinciana Villages*, ASS’N POINCIANA VILLAGES, <https://www.apvcommunity.com> [<https://perma.cc/HC6N-U5AG>].

240. *See Riverstone*, RIVERSTONE DEV. CO., [riverstone.com](https://www.riverstone.com) [<https://perma.cc/J9QE-S9WT>].



penses in the 2018 tax year.<sup>241</sup> Riverstone took in about \$7.8 million in revenue and almost the same in expenses in the 2017 tax year.<sup>242</sup> Riverstone asserts it promotes the health, safety, and welfare of its residents.<sup>243</sup> It hires a management company to maintain the neighborhood.<sup>244</sup> From a review of data from Forms 990, there appear to be a small number of homeowners' associations that earn between \$1 and \$3 million annually.<sup>245</sup> But most social welfare organization homeowners' associations are very small, like the \$80,000 revenue a year Deerfield Homeowners' Association out of Fillmore, California.<sup>246</sup> Many likely are too small to be required to file a tax return with the IRS.

### C. *Tax Consequences of Forming as a Social Welfare Organization*

A person forms a social welfare organization by incorporating a nonprofit corporation under state law.<sup>247</sup> He or she then files a Form 1024 with the IRS seeking recognition as exempt from taxation under section 501(c)(4) of the Code.<sup>248</sup> The newly formed organization can then raise money through contributions, business operations (primarily activities that further its purpose), and loans.<sup>249</sup> As long as it conducts business substantially related to its purpose, its income is exempt from the federal income tax.<sup>250</sup>

A contributor to a social welfare organization may not deduct his or her contribution as a charitable contribution under section 170 of the

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241. Ass'n of Poinciana Villages Inc., Form 990: Return of Organization Exempt from Income Tax, pt. 1, §§ 12, 19, at 1 (2018), [https://projects.propublica.org/nonprofits/display\\_990/591514293/02\\_2020\\_prefixes\\_59-64%2F591514293\\_201812\\_990O\\_2020021017132522](https://projects.propublica.org/nonprofits/display_990/591514293/02_2020_prefixes_59-64%2F591514293_201812_990O_2020021017132522) [<https://perma.cc/HDT6-HJ68>].

242. Riverstone Homeowners Ass'n, Inc., Form 990: Return of Organization Exempt from Income Tax, pt. 1, §§ 12, 18, at 1 (2017), <https://pdf.guidestar.org/PDF/Images/2017/760/684/2017-760684372-0fffd669-9O.pdf> [<https://perma.cc/5MUA-H6GD>].

243. *Id.* pt. I, § 1, at 2.

244. *Id.* pt. VI, § A, at 6.

245. Based on Author's own review of organizations on ProPublica that identified as homeowners' associations. *See generally*, Ken Schwencke et al., *Nonprofit Explorer: Research Tax-Exempt Organizations*, PROPUBLICA <https://projects.propublica.org/nonprofits/> (Nov. 19, 2020) [<https://perma.cc/5S46-SU76>] (providing the ProPublica database Author used in his review).

246. Deerfield Homeowner's Ass'n, Form 990: Return of Organization Exempt from Income Tax, pt. I, § 9, at 1 (2018), <https://pdf.guidestar.org/PDF/Images/2018/770/083/2018-770083789-10fad0ad-ZO.pdf> [[HTTPS://PERMA.CC/UV9W-G46H](https://perma.cc/UV9W-G46H)].

247. Nothing prohibits a social welfare organization from forming as a charitable trust, like a charitable organization is permitted to do under 26 U.S.C. § 501(c)(3).

248. 26 U.S.C. § 506 (requiring social welfare organizations to file a notice with the IRS "not later than [sixty] days after the organization is established"); Form 1024: Application for Recognition of Exemption Under Section 501(a), 1 (2018), <https://www.irs.gov/pub/irs-pdf/f1024.pdf> [<https://perma.cc/TG98-5EHA>].

249. Form 1024: Application for Recognition of Exemption Under Section 501(a), at 5 (2018), <https://www.irs.gov/pub/irs-pdf/f1024.pdf> [<https://perma.cc/TG98-5EHA>].

250. 26 U.S.C. §§ 501(c)(4), 511–514.

Code. However, in addition to possibly deducting a transfer to a social welfare organization under another section of the Code,<sup>251</sup> contributors can obtain tax benefits from certain contributions. A contributor who donates appreciated assets does not recognize the gain on the contribution. For instance, assume Sarah owns stock she bought for \$100 that is now worth \$1,000. Sarah can contribute that stock to a social welfare organization and avoid recognition of the gain inherent in that stock.<sup>252</sup> This allows Sarah a deduction in effect. The social welfare organization is carrying out \$1,000 of activity Sarah supports at a tax cost of only \$100 worth of income to Sarah. Had she first sold the stock and contributed the cash, she would have had to pay tax on the \$900 gain. By transferring the appreciated asset to a social welfare organization, she avoids income tax on \$900.

A social welfare organization might owe tax if it engages in an unrelated business,<sup>253</sup> which is a business activity that does not substantially further the organization's purpose of promoting social welfare.<sup>254</sup> Thus, a social welfare organization that runs a lawn mowing business on the side would most likely have to pay tax on that activity. If that activity was too substantial, the organization would no longer be considered exempt from income tax.

Additionally, since 2016, a contribution to a social welfare organization is no longer subject to the gift tax.<sup>255</sup> Sarah can thus make unlimited gifts to a social welfare organization without needing to worry about the gift tax.

The bottom line is that a person who chooses to further his or her interests through a social welfare organization gains some tax benefits. First, he or she can avoid both an income tax on gains on appreciated assets and a gift tax on any contribution. Second, no tax is owed on profits earned by the social welfare organization in any taxable year as long as the profits are from a related trade or business.

#### IV. RATIONALES FOR TAX EXEMPTION

Congress provides for exemption from the federal corporate income tax for most nonprofit entities in the United States.<sup>256</sup> While the rationale for this exemption used to be unstudied, the matter has received increasing attention.<sup>257</sup> Most of that work remains focused on

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251. For instance, a contributor might be able to deduct a payment as a trade or business expense under 26 U.S.C. § 162.

252. *Cf.* 26 U.S.C. § 84 (making the contribution of appreciated assets to a political organization a realization event).

253. 26 U.S.C. § 511.

254. 26 U.S.C. § 513.

255. 26 U.S.C. § 2501(a)(6).

256. 26 U.S.C. § 501(a).

257. See Ellen P. Aprill, *Regulating the Political Speech of Noncharitable Exempt Organizations After Citizens United*, 10 *ELECTION L.J.* 363, 365–66 (2011); Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 *B.C. L. REV.* 501, 504–05 (1990).

charitable organizations, but an increasing number of scholars also consider other tax-exempt entities.<sup>258</sup> The initial forays contended that the exemption amounted to a *quid pro quo* in return for some collective service or good the government might have provided on its own.<sup>259</sup> Others argued it made no sense to count the gains of some nonprofits, like charities, as income.<sup>260</sup> Most theories instead assume that the corporate income tax *should* apply to all corporations.<sup>261</sup>

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[hereinafter *Altruism in Nonprofit*]; Rob Atkinson, *Theories of the Federal Income Tax Exemption for Charities: Thesis, Antithesis, and Syntheses*, 27 STETSON L. REV. 395, 396 (1997); Boris I. Bittker & George K. Rahdert, *The Exemption of Nonprofit Organizations from Federal Income Taxation*, 85 YALE L.J. 299, 301 (1976) [hereinafter *Exemption of Nonprofit Organizations*]; Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585, 585 (1998); Nina J. Crimm, *An Explanation of the Federal Income Tax Exemption for Charitable Organizations: A Theory of Risk Compensation*, 50 FLA. L. REV. 419, 420 (1998); Miranda Perry Fleischer, *Libertarianism and the Charitable Tax Subsidies*, 56 B.C. L. REV. 1345, 1345 (2015); Miranda Perry Fleischer, *Charitable Giving and Utilitarianism: Problems and Priorities*, 89 IND. L.J. 1485, 1486 (2014); Miranda Perry Fleischer, *Equality of Opportunity and the Charitable Tax Subsidies*, 91 B.U. L. REV. 601, 603–04 (2011); Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505, 507–08 (2010); Mark A. Hall & John D. Colombo, *The Charitable Status of Nonprofit Hospitals: Toward a Donative Theory of Tax Exemption*, 66 WASH. L. REV. 307, 313 (1991); Mark A. Hall & John D. Colombo, *The Donative Theory of the Charitable Tax Exemption*, 52 OHIO ST. L.J. 1379, 1381–82 (1991); Daniel Halperin, *Is Income Tax Exemption for Charities a Subsidy?*, 64 TAX L. REV. 283, 283 (2011) [hereinafter *Charities a Subsidy?*]; Daniel Halperin, *Income Taxation of Mutual Nonprofits*, 59 TAX L. REV. 133, 135 (2006) [hereinafter *Mutual Nonprofits*]; Henry Hansmann, *The Rationale for Exempting Nonprofit Organizations from Corporate Income Taxation*, 91 YALE L.J. 54, 55 (1981) [hereinafter *The Rationale*]; Daniel Jacob Hemel, *Tangled Up in Tax: The Nonprofit Sector and the Federal Tax System*, in THE NONPROFIT SECTOR: A RESEARCH HANDBOOK 1 (Walter W. Powell & Patricia Bromley eds., 3d ed. 2019); Lawrence M. Stone, *Federal Tax Support of Charities and Other Exempt Organizations: The Need for a National Policy*, 20 MAJOR TAX PLAN. 27, 27 (1968) [hereinafter *Federal Tax Support*]; Burton Weisbrod, *Toward a Theory of the Voluntary Nonprofit Sector in a Three-Sector Economy*, in THE ECONOMICS OF NONPROFIT INSTITUTIONS 37 (Susan Rose-Ackerman ed., 1986) [hereinafter *Theory of the Voluntary*].

258. For example, a symposium recently considered the appropriateness of the exemption of social welfare organizations. 2017 New York University's National Center on Philanthropy and Law's Conference, "Social Welfare Organizations: A Better Alternative to Charities?"

259. See *Federal Tax Support*, *supra* note 257, at 45.

260. *Exemption of Nonprofit Organizations*, *supra* note 257, at 307–08, 315. Bittker and Rahdert also argued: (1) a tax on charitable activity would unfairly apply the high corporate tax rate to individual consumption that ought to be taxed at a lower rate; and (2) it might just be administratively inconvenient to apply a tax to organizations that do not amount to much of any economic activity. *Id.* All the same, they acknowledged many categories of exempt organizations, like business associations, generated taxable income. *Id.*

261. *The Rationale*, *supra* note 257, at 55. There is also a long literature considering who bears the incidence of the corporate income tax. It could be shareholders, labor, consumers, or worldwide holders of capital. Jennifer Gravelle offers a rundown of some of the theories. Jennifer Gravelle, *Corporate Tax Incidence: Review of General Equilibrium Estimates and Analysis*, 66 NAT. TAX J. 185 (2013).

Those theorists then view exemption as a subsidy equal to the annual tax the nonprofit would have paid in tax without the exemption.<sup>262</sup>

There are two dominant rationales<sup>263</sup>: Henry Hansmann's efficiency rationale<sup>264</sup> and Burton Weisbrod's government-failure rationale.<sup>265</sup> Both seem to assume that the results of a free market are the ideal ends of a well-designed tax policy.<sup>266</sup>

Hansmann argues the government could subsidize those nonprofits that provide goods and services that are not produced at an efficient market level because of a market failure.<sup>267</sup> For instance, there is a classic case of market failure as a result of asymmetric information when it comes to aiding the poor in a foreign country.<sup>268</sup> The donors who provide the aid cannot ensure its quality or its arrival.<sup>269</sup> We can thus expect less aid, and less quality aid, to arrive than is optimal. Because there are no owners of a nonprofit, donors can have confidence in nonprofits to provide these goods and services.<sup>270</sup> Still, the lack of owners means it is harder to generate the necessary capital to build the operation.<sup>271</sup> With a governmental subsidy through tax exemption, we might approach a more efficient provision of these types of goods and services. Hansmann is less sanguine about much of the rest of the exempt sector such as social clubs because he is suspicious that there is no efficiency problem that these organizations solve and believes they can raise necessary capital.<sup>272</sup>

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262. For instance, Halperin makes this assumption based on the belief that the income tax should be designed to properly measure income. *Mutual Nonprofits*, *supra* note 257, at 135.

263. There are others, such as exemption for nonprofits, that might foster pluralism. See *Taxing the Unheavenly*, *supra* note 14, at 268, n.12 (discussing some of the sources that make this argument).

264. *The Rationale*, *supra* note 257, at 72. See also *Charities a Subsidy?*, *supra* note 257, at 294–97 (adopting Hansmann's contract failure analysis to examine charitable organizations). There are a number of scholars who contest this efficiency rationale. For instance, in *Altruism in Nonprofit*, Rob Atkinson argues that we subsidize charitable nonprofits to encourage altruism and to encourage redistribution of resources. *Altruism in Nonprofit*, *supra* note 257, at 633–34. See also Daniel Shaviro, *Assessing the "Contract Failure" Explanation for Nonprofit Organizations and Their Tax-Exempt Status*, 41 N.Y.L. SCH. L. REV. 1001, 1006–07 (1997) (arguing that Hansmann's underinvestment hypothesis is likely wrong and that exempt organizations may also over invest in domains such that a penalty could be called for instead of a subsidy; though ultimately Shaviro argues for an efficiency rationale to support those organizations that provide some positive externality).

265. *Theory of the Voluntary*, *supra* note 257.

266. See *The Rationale*, *supra* note 257, at 72; *Theory of the Voluntary*, *supra* note 257.

267. *The Rationale*, *supra* note 257, at 54–55, 70.

268. *Id.* at 69–70.

269. *Id.* at 69.

270. *Id.* at 70 & n.57. Cf. Anup Malani & Eric A. Posner, *The Case for For-Profit Charities*, 93 VA. L. REV. 2017, 2024 (2007).

271. *The Rationale*, *supra* note 257, at 72.

272. *Id.* at 94–95.

Weisbrod argues that tax-exempt organizations provide an opportunity to solve a problem he calls "government market failure."<sup>273</sup> Because majorities rule in a democracy, there will always be some substantial minority that is unable to accomplish its governmental goals of providing certain collective goods.<sup>274</sup> Tax-exempt entities provide a government-financed avenue for satisfying the public good needs and wants of this minority.<sup>275</sup>

What have scholars said regarding social welfare organizations? Lloyd Hitoshi Mayer argues that most social welfare organizations probably are legitimately tax exempt because "the act of aggregating funds for the purpose of pursuing a collective, non-business (i.e., not for-profit) activity should not be subject to tax as long as any net income is either refunded to the persons supporting the activity (i.e., dues-paying members), or retained for future use that furthers the nonprofit's purposes."<sup>276</sup> The exemption from tax for investment income and capital expenditures cannot, however, be justified as a pooling of nontaxable activity. Mayer thus argues social welfare organizations should pay tax on investment income. Overall, Mayer finds exemption for social welfare organizations a useful solution for those trying to conduct community-based activity in a tax-exempt form that does not quite meet the section 501(c)(3) standard.<sup>277</sup>

Ellen Aprill argues there is practical reason to believe the section's broad nature serves an important purpose.<sup>278</sup> It safeguards "the limits of [section] 501(c)(3) and . . . defend[s] the integrity of [section] 501(c)(3)," by fulfilling a boundary protecting function.<sup>279</sup> Its most important boundary-keeping role might be to keep the lobbying limitation on charitable organizations constitutional.<sup>280</sup> While the IRS admitted some organizations that were not quite charitable to the social-welfare fold, these acts arguably provided a signal to Congress which eventually created new tax exempt categories for these organizations. In that sense it protected the boundary of charitable organizations.

Roger Colinvaux sees the ability to use social welfare organizations to intervene in campaigns and avoid campaign finance laws to be a

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273. *Theory of the Voluntary*, *supra* note 257, at 22.

274. *Id.* at 30–31, 33.

275. *Id.* at 30.

276. *A (Partial) Defense*, *supra* note 128, at 469–70.

277. *Id.* at 447, 480.

278. *Examining the Landscape*, *supra* note 9, at 348 (citing John Simon, Harvey Dale & Laura Chisolm, *The Federal Tax Treatment of Charitable Organizations*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* 267, 284–92 (Walter W. Powell & Richard Steinberg eds., 2d ed. 2006) (arguing that charitable tax exemption plays a border control function to ensure that neither the commercial nor the governmental sector carries out charitable activity)).

279. *Id.* at 383.

280. *Id.* at 376.

corrupting influence on the nonprofit sector as a whole.<sup>281</sup> He thinks this problematically leads to a sense that social welfare organizations are tax shelters, when, to Colinvaux, they are disclosure shelters.<sup>282</sup> He argues that the primary change needed within the social-welfare sphere is clarity of the law particularly with respect to political activity disclosure.<sup>283</sup> Colinvaux acknowledges that the IRS is probably not the best institution from which to require disclosure but thinks the non-disclosure harm outweighs the institutional harm.<sup>284</sup> He also argues that we ought to tax contributors on appreciated assets transferred to social welfare organizations.<sup>285</sup>

While the above scholarship explicitly focuses on the role of social welfare organizations under federal income tax law, there is a broader literature on nonprofits that can inform our consideration as well. Philosophers, sociologists, and historians look at the role of nonprofits within a democratic capitalist system, too. Rob Reich, for example, in *Just Giving*, frames the question of philanthropy as: “given the ubiquity and universality of philanthropy, what attitude should a state have toward the preference of people to give money away for some prosocial or public purpose?”<sup>286</sup> As currently regulated, he believes the vast money in the philanthropic sector, which surely includes social welfare organizations, has become a plutocratic force. The amount of money from wealthy interests going into philanthropy is turning us into an oligarchy, and away from a liberal democracy, because wealth is determining our social solutions for us. He argues we need a political theory of philanthropy.<sup>287</sup>

Historian Jonathan Levy contends that nonprofits today work to “pass through” wealth, power, and rights to wealthy individuals rather

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281. *Plague of Inconsistency*, supra note 201, at 495.

282. *Id.* at 498; see also Criminal Complaint at 15 ¶ 45, *United States v. Borges*, No. 1:20-MJ-00526 (D. Ohio July 17, 2020). This criminal complaint was filed for an enormous bribery scheme against Larry Householder, the Speaker of the House of Representatives of the state of Ohio, along with a connected social welfare organization. *Id.* One quote in the complaint is particularly telling: “Clark discussed with Householder, the use of a 501(c)(4), controlled by Householder, to receive payments: ‘what’s interesting is that there’s a newer solution that didn’t occur in, 13 years ago, is that they can give as much or more to the (c)(4) and nobody would ever know. So you don’t have to be afraid of anyone because there’s a mechanism to change it.’” *Id.*

283. *Plague of Inconsistency*, supra note 201, at 501–02.

284. *Id.* (citing Lloyd H. Mayer, *The Much Maligned 527 and Institutional Choice*, 87 B.U. L. REV. 625, 682 (2007) (arguing that the FEC rather than the IRS should be the institutional choice for monitoring disclosure)).

285. *Id.* at 503 (citing Gregg D. Polsky & Guy-Uriel E. Charles, *Regulating Section 527 Organizations*, 73 GEO. WASH. L. REV. 1000, 1013–14 n.81 (2005) (arguing that this rule ought to apply to all exempt organizations except charitable ones)).

286. ROB REICH, *JUST GIVING: WHY PHILANTHROPY IS FAILING DEMOCRACY AND HOW IT CAN DO BETTER* 195 (2018).

287. *Id.* at 15.

than carry out publicly minded missions.<sup>288</sup> Aaron Horvath and Walter W. Powell are concerned about what they term *disruptive philanthropy*: “[I]nitiatives, we contend, crowd out the public sector, further reducing both its legitimacy and its efficacy, and replace civic goals with narrower concerns about efficiency and markets.”<sup>289</sup> As some tax scholars believe the potential for wealthy interests to make problematic tax use of social welfare organizations at a greater level than a charitable organization,<sup>290</sup> these are concerns we should have with the social welfare sector as well.

## V. ANALYSIS

This Part primarily evaluates the income tax regime applicable to social welfare organizations from the perspective of political justice as described in Part II. Thus, the primary question is whether tax exemption for social welfare organizations is just because it does not harm equal political voice and perhaps enhances it. There are two primary issues here. First, what is the relationship between social welfare organization tax exemption and PVE? Second, what is the role of social welfare organizations in ensuring some of the essential rights to a democratic order identified in Part I.B, such as the freedom of speech, association, and free and fair elections?

I first consider social welfare organizations as a part of our democratic order. I then consider whether the tax treatment of social welfare organizations amounts to a subsidy. Next, I apply a political justice critique to social welfare organizations by examining three types of specific social welfare activity/organization, which I mentioned above in Part II.B: advocacy, health services/insurance, community clubs/homeowners’ associations. I also evaluate these questions in light of Hansmann’s contract failure theory and Weisbrod’s government failure theory. I consider broader implications of this analysis such as its impact on the rest of the sector, specifically asking what this analysis may imply for the charitable sector. Finally, I suggest some implications of this political justice analysis for the rest of the Code.

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288. Jonathan Levy, *From Fiscal Triangle to Passing Through: Rise of the Nonprofit Corporation*, in *CORPORATIONS AND AMERICAN DEMOCRACY* 217 (Naomi R. Lamoreaux & William J. Novak eds., 2017).

289. Aaron Horvath & Walter W. Powell, *Contributory or Disruptive: Do New Forms of Philanthropy Erode Democracy?*, in *PHILANTHROPY IN DEMOCRATIC SOCIETIES* 89 (Rob Reich, Chiara Cordelli & Lucy Bernholz eds., 2016).

290. David S. Miller, *Social Welfare Organizations as Grantmakers*, 21 N.Y.U. J. LEGIS. & PUB. POL’Y 413, 437 (2018).

### A. *Social Welfare Organizations as a Part of Civil Society*

A vibrant civil society is a long-acknowledged, important part of a just political system.<sup>291</sup> As discussed in the Introduction and in Part II, civil society consists of associations and institutions that facilitate the formation of public opinions in spaces located outside of the for-profit or governmental sectors.<sup>292</sup> Much of the nonprofit, tax-exempt sector including many within the social welfare organization sector likely fit within this definition of civil society. A deliberative democratic theorist might question whether some of the organizations that qualify as social welfare organizations legitimately fit into civil society. For instance, large business operations such as HMOs or big-business-backed advocacy organizations appear to be a part of the economic order instead of a sector separate from for-profit and governmental sectors and thus would fall outside of civil society. Nevertheless, in understanding how to design tax policy for social welfare organizations in a politically just way, we should consider the role they play in civil society. While the democratic traditions discussed in Part II.B all find a strong civil society an important part of a democratic order, they each have different takes on what role these organizations ought to play in a politically just order.

For somewhat different reasons, each democratic tradition finds that freedom of association, speech, information, and free and fair elections are critical to a well working and just order. Some definitions of civil society include these freedoms.<sup>293</sup> This makes sense as civic associations often play a role in protecting these freedoms. Thus, the formation of these organizations is in itself important to a democratic order.

As discussed in Part I.B, republican theorists view civil society with mixed feelings. In part, they fear civil-society associations because they express selfish interests that conflict with the general will of the state.<sup>294</sup> Nevertheless, the republican theorist thinks civil society is

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291. THEDA SKOCPOL, *DIMINISHED DEMOCRACY* 20–24 (2003) (discussing how civic associations in the United States served and continue to serve as schools of democracy and of solidarity for the political order) [hereinafter *DIMINISHED DEMOCRACY*].

292. *Three Normative Models*, *supra* note 13, at 8; *BETWEEN FACTS*, *supra* note 58, at 298–99.

293. See *Protecting and Expanding Civic Space*, UNITED NATIONS OFF. OF THE HIGH COMM’R FOR HUM. RTS., [https://www.ohchr.org/EN/Issues/CivicSpace/Pages/\[https://perma.cc/TJ6A-XR3C\]](https://www.ohchr.org/EN/Issues/CivicSpace/Pages/[https://perma.cc/TJ6A-XR3C]).

294. See, e.g., *DEMOCRACY AND ITS CRITICS*, *supra* note 35, at 289 (“All political societies are composed of other, smaller societies of different types, each of which has its interests and maxims . . . . The will of these particular societies always has two relations: for the members of the association, it is a general will; for the large society, it is a private will, which is very often found to be upright in the first respect and vicious in the latter” (quoting JEAN-JACQUES ROUSSEAU, *ON THE SOCIAL CONTRACT*, WITH GENEVA MANUSCRIPT AND POLITICAL ECONOMY 212–13 (Roger D. Masters ed., Judith R. Masters trans., 1978))).



critical to a just order. James Madison warned of factions, but found that government should not prohibit factions; it should hinder factions through political structure instead.<sup>295</sup> Alexis de Tocqueville thought civil society was the lifeblood of democracy.<sup>296</sup> Some modern republican theorists argue non-domination by the state is an important principle and see civil society as a bulwark to protect the individual from arbitrary intervention by the state.<sup>297</sup>

Within the liberal order, civil society serves a fundamental role in protecting freedom of speech and association, and two primary functions. First, politics is a battle between interests that fight for the right of their idea to be ascendant.<sup>298</sup> Associations bring important information to the government in that battle and the government referees that fight. Second, civic life is a place for individuals to take care of themselves through voluntary action.<sup>299</sup> If a nonprofit is the best provider of a service, the state ought not stand in the way of that effort.

As discussed in Part II.B, the deliberative democratic theorist argues civil society's most important role is to energetically keep open the communication structures of a broad public sphere.<sup>300</sup> In effect, the goal of associations of civil society ought to be improving the quality, quantity, and diversity of deliberation in the public sphere. This is a different role than that conceived of by either the liberal or republican traditions, though it may be closer to republican because of its efforts to find a common will. Habermas developed his theory in part in fear of the consequences of a republican tradition that prioritized the state, which he believed led to problematic "totalitarian societies of bureaucratic socialism."<sup>301</sup> Modern republican theorists who see civil society as a bulwark against the state seem to agree with this concern and analysis of deliberative democratic theory.<sup>302</sup>

Thus, there is broad agreement that political justice as democracy includes freedom to form and operate associations like social welfare organizations and just about any nonprofit entity. With that said, at least within the deliberative democratic tradition, it is not clear that the health sector as a major business would fit into this role, nor the advocacy organizations for big business. The theorists of the different traditions also believe in the fundamental equality of each person and

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295. THE FEDERALIST NO. 10, at 48 (James Madison) (Yale Univ. Press ed., 2009).

296. ALEXIS DE TOQUEVILLE, DEMOCRACY IN AMERICA 490 (Henry C. Mansfield & Delba Winthrop eds., 2000).

297. FREEDOM AND GOVERNMENT, *supra* note 74, at 148.

298. *See supra* Part II.B.

299. *See supra* Part II.B.

300. BETWEEN FACTS AND NORMS, *supra* note 58, at 369.

301. BETWEEN FACTS AND NORMS, *supra* note 58, at 369.

302. *See, e.g.*, FREEDOM AND GOVERNMENT, *supra* note 74, at 147–48; *see also supra* Part II.B (arguing civil society is a bulwark to protect individuals from arbitrary actions of the state).

his or her right to PVE.<sup>303</sup> Part of our political justice analysis must, therefore, be to determine what role tax exemption plays in ensuring a freedom to form these associations. Critically though, as discussed in Part II, there is a recognition that unequal resources for these groups can lead to unequal voice before the legislature.

B. *Is Tax Exemption for Social Welfare Organizations a Subsidy?*

As a matter of income tax, should transfers of value in and out of a social welfare organization be subject to tax? Transfers of things of value in and out of a typical partnership and corporation are generally subject to taxation.<sup>304</sup> Accordingly, we know these entities are thought to conduct business that gives rise to taxable income. Conversely, we tend to think transfers of things of value in and out of charitable organizations, like a soup kitchen, ought not be subject to taxation. This question regarding whether transfers of value in and out of a social welfare organization matters because if there is no reason to tax the income in the first place, then we need not justify *exempting* the income from tax because there is no income to tax. In this part, I argue that outside a context I refer to as pooling associated with small organizations, we should consider exemption from income tax a subsidy for social welfare organizations.

There are a few primary points where a social welfare organization might generate income that could be subject to tax: (1) member contributions, (2) business activity, and (3) investment income.

Member contributions generally include payments like dues to a nonprofit corporation from a member of a homeowner's association, service club, or kids' recreational group.<sup>305</sup> It would also include payments to advocacy organizations for the purpose of supporting a particular electoral or lobbying cause.<sup>306</sup> Should these contributions be treated as payment for services that ought to trigger income at the corporate level? Business activity includes such things as payments for medical insurance coverage at an HMO or the revenue that a skating rink or a horse racing track generates in operating that business. For tax purposes, that business activity can be considered related or unrelated to the social welfare purpose. An unrelated business activity is already considered taxable by law.<sup>307</sup> Finally, by investment income I mean the income generated in a taxable year from the portfolio of investments held by the organization. This income is generally not

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303. See *supra* Part II.A.

304. Still, some partner contributions to the organization in return for their partner share are generally not taxed. 26 U.S.C. § 721. Also, some shareholder contributions to a corporation are not taxed. 26 U.S.C. § 351(a)–(d).

305. See 26 U.S.C. § 527(c)(3).

306. Some of this is consistent with “exempt function income” as described in 26 U.S.C. § 527(c)(3).

307. 26 U.S.C. § 511(a)(1).

taxed because it is not considered unrelated business taxable income.<sup>308</sup>

Tax law generally views a corporation as a separate person, distinct from its contributors.<sup>309</sup> Thus, transfers in and out of a corporation, including one that is nonprofit, are thought to be taxable. Nevertheless, many argue that a lot of nonprofits, including those in the social welfare category, are simply engaged in the pooling of resources on behalf of individuals to accomplish something each individual could have accomplished on his or her own.<sup>310</sup>

For example, assume Bob, Sue, and Betty decide to build a swimming pool together. Assume a year ago they each paid to build a pool. Now they keep an account from which they pay annual costs. Each pays \$1,000 during the year to properly maintain the pool. The maintenance includes paying someone to regularly clean the pool and ensure it is ready for use. Total actual costs of running the pool in the year, including depreciation, amount to \$2,700 (\$900 per person). It is possible that we could think of the pool activity as a legal entity. If we did, we might say that entity earned \$300 in income and ought to pay a corporate tax on \$300 of income. But the tax law generally does not work in this way in such an endeavor. In effect, the tax law would treat the parties as if this activity was in their individual capacity.<sup>311</sup> Bob could have paid to build and maintain a pool on his own—that he happens to enter into this activity with two other people should not generally change this result. Likewise, many argue that it is reasonable to think of the activity of some nonprofits, like social welfare organizations, to be the same type of pooling activity.<sup>312</sup>

If we accept this characterization, there is no subsidy to the organization because there is no accession to wealth that should be taxed. Those who argue this are likely arguing that contributions like member dues should not generate taxable income. Any surplus at the end of the year is simply an account that is maintained in common for the convenience of all members. Members are doing nothing other than buying services or goods in common and keeping track of that through a corporate entity. Thus, when a member of Kiwanis pays monthly dues to pay for a facility and a weekly lunch, there should not be an additional recognition of gain at the corporate level. Each member just bought lunch and space with some other people. It is no different than Bob, Sue, and Betty's pool operation.

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308. *Id.*

309. *Moline Props., Inc. v. Comm'r*, 319 U.S. 436, 438–39 (1943).

310. See, e.g., *A (Partial) Defense*, *supra* note 128, at 469–70 (citing *Exemption of Nonprofit Organizations*, *supra* note 257, at 348–49); *supra* Part III (discussing this argument).

311. See, e.g., Treas. Reg. 301.7701-1(a)(2) (as amended in 2011) (discussing when a joint undertaking becomes a separate entity for tax purposes).

312. See *Altruism in Nonprofit*, *supra* note 257, at 570.

Not all social welfare organizations can be described as only pooling resources—HMOs do not fit this model for one. However, for those social welfare organizations with small operations, it seems relatively unobjectionable to approach the matter in this way. But, once an organization reaches some size, this claim ought to have less power because it becomes unrealistic. There is a vast difference between a couple hundred friends spending less than \$500,000 over the year to meet weekly for lunch, and a multi-million dollar business providing conference services for people around the country. There is a significant economy-of-scale difference of the value flowing in the two different operations. This could suggest that individual Kiwanis clubs with revenue under \$500,000 on an annual basis, or a similar kids' sports recreation league, have no income to impose a tax upon. There is no subsidy in these situations because they should not pay tax upon such pooling activity.

However, justifying nontaxation on pooling grounds does not explain the tax-exempt treatment of business or investment income, which would be taxable in the normal income tax. For example, a Kiwanis club that ran a bookstore or invested in the stock market to support its operations would not just be pooling resources in a nontaxable way. The pooling theory also cannot explain the nontaxation of contributions of appreciated property.<sup>313</sup>

Still, there is another difficulty to the primary question of whether there is a subsidy to social welfare organizations. If our purpose for applying the income tax is to adjust individual taxable burdens based on ability to pay, applying a tax to a corporate entity obscures our view of whether we are accomplishing this goal.<sup>314</sup> Realistically, if we do not tax individuals currently on the income of a corporate entity, we provide an opportunity for individuals to defer income tax in corporate solution, which generates tax benefits. Thus, the corporate tax prevents the lowering of a tax burden by deferring tax in a nontaxable corporate entity.<sup>315</sup>

Income is defined as an accession to wealth, clearly realized, over which the taxpayer has complete dominion.<sup>316</sup> This accords in part with the Haig Simons definition of income that provides the base of our U.S. concept of income.<sup>317</sup> If the only question is whether a partic-

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313. See *A (Partial) Defense*, *supra* note 128, at 471.

314. Philip T. Hackney, *What We Talk About When We Talk About Tax Exemption*, 33 VA. TAX REV. 115, 118 (2013) [hereinafter *Talk About Tax Exemption*] (arguing that all mutual benefit organizations should be presumed to be taxable unless there is a strong policy reason for subsidizing the activity).

315. Notably, after Congress lowered the corporate income tax to 21% in the 2017 Tax Act, there is an opportunity to seek lower tax overall through this deferral mechanism. 26 U.S.C. § 11.

316. *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 477 (1955).

317. Alice G. Abreu & Richard K. Greenstein, *Defining Income*, 11 FLA. TAX REV. 295, 306 (2011).

ular corporation as a taxpayer has an accession to wealth, that is clearly realized over which it has dominion, a nonprofit corporation would generate income that should be taxed to the extent it is not a gift or a gain excluded from income.

However, if the question is whether a shareholder experienced those gains, we can only see that through a diffuse filter. This problem is the same whether the entity is for-profit or nonprofit. Someone benefits from the economic activity of a corporation, even if we do not know who. In the for-profit case, a shareholder has a real relationship to the corporate gains. We view pass-through entities such as partnerships in this way, too. Whether the partner receives money or not, we allocate the gain for tax purposes to the partner.<sup>318</sup> Similarly, in the case of a grantor trust, whether the grantor receives money or not, we allocate the income of the trust to the grantor.<sup>319</sup>

With a nonprofit organization we do not consider the controlling individuals to have income because they have no accession to wealth, no clearly realized income, and no dominion over that wealth. Thus, if our vision was purely of a shareholder theory of the corporate income tax, we would likely never tax nonprofit organization income.<sup>320</sup>

I have argued that we should assume that nonprofits controlled by members to benefit members (mutual benefits) should be considered to accumulate taxable income on behalf of their members.<sup>321</sup> In the case of a public benefit organization, such as charitable organizations, this presumption should generally not hold. If operated properly, the benefits from the operation of the charity are largely public in nature. There are no shareholder-like individuals who we might say the tax is there to impose a burden upon.<sup>322</sup> To the extent the activity truly helps the poor, we might even think that the corporate rate of 21% is inappropriate to apply to such individuals who likely owe at a 0% rate. There may still be reasons to tax the entity, such as to regulate the activity by imposing a tax to limit the power of those who control the entity, or tax the entity because that's where money is, but the shareholder theory would not explain the reason for taxing the charity.

Where do social welfare organizations fit in this order? While there is great commonality among the organizations that fit into the mutual benefits, there is little commonality within the group that makes up social welfare organizations.<sup>323</sup> The sector cannot be thought to fit into either the mutual benefit or the public benefit category.

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318. 26 U.S.C. § 704(c)(1)(B)(ii).

319. 26 U.S.C. § 671.

320. *Talk About Tax Exemption*, *supra* note 314, at 150.

321. *Id.* at 151–54.

322. Andrews, *supra* note 17, at 314–15 (arguing that gains incurred for collective purposes, such as in a charitable organization, ought not be taxed).

323. FROM CAMPS TO CAMPAIGN FUNDS, *supra* note 9, at 128.

The activity of social welfare organizations is almost by definition more private than that of charitable organizations. Social welfare organizations possess a lesser status than do charitable organizations. Most prominently, Congress grants a charitable contribution deduction to an individual who makes a donation to a charitable organization but not to those who make a donation to a social welfare organization.<sup>324</sup> Additionally, there are more restrictions on charity by statute, such as limitations on political and lobbying activity, than there are on social welfare organizations. As discussed above in Part III, the law contains little to guide a social welfare organization in how to qualify. The charitable organization statute, though vague, came with a set body of common law of charitable trusts to give immediate content to a relatively vague statute.<sup>325</sup> With social welfare, there was no law from which we could draw the rules of what fits within that purpose.

One additional complexity is that we generally do not tax political organizations on their income, aside from investment income.<sup>326</sup> I raise this because the advocacy organizations at least could be thought to fit into this tax-exempt category. Historically, the IRS did not apply tax to political organizations.<sup>327</sup> Congress codified this practice in section 527 in 1974.<sup>328</sup> There is no deduction for contributors to political campaigns,<sup>329</sup> and we require the payment of the income tax on a transfer of appreciated property to a political organization.<sup>330</sup> Normatively, we might choose not to tax this activity because it does look like the pooling of income. But, maybe more importantly, it might be troubling to imply political campaigns are run for transactional purposes. Finally, we may also not want to hinder political activity.

In summary, outside a relatively narrow pooling context, there is a good claim that exemption from income tax in the case of a social welfare organization ought to be thought of as a subsidy. There are some complicating factors to that case. However, given the more selfish nature of social welfare organizations than charitable organizations, and that in many instances substantial businesses are operated within this sector, we ought to come up with a sufficient justification for this exemption.

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324. 26 U.S.C. § 170.

325. *See, e.g.,* Bob Jones Univ. v. United States, 461 U.S. 574, 598 (1983).

326. 26 U.S.C. § 527(b)–(c). The unrelated business income tax under 26 U.S.C. § 511 does not apply to political organizations.

327. I.R.S., *IRC 527 - Political Organizations* (1989), <https://www.irs.gov/pub/irs-tege/eotopici89.pdf> [<https://perma.cc/E8PG-VKKU>]; *see* Rev. Proc. 68-19, 1968-1 C.B. 810 (holding that political funds were not taxable income to the candidate involved); *see also* I.R.S. Announcement 73-84, 1973-2 C.B. 461 (1973).

328. Pub. L. 93-625, § 10(a), Jan. 3, 1975, 88 Stat. 2116.

329. 26 U.S.C. § 162(e)(1)(B).

330. 26 U.S.C. § 84.

C. *What Does Democratic Political Justice Say About Providing a Subsidy to Social Welfare Organizations?*

In this Section, I first consider the implications for tax purposes from the conclusion of Part V.A that civic associations, like social welfare organizations, ought not be hindered by the state because our democratic traditions consider them an important part of civil society. This raises two broad questions: (1) is this policy right as to advocacy organizations, and (2) is this policy right as to organizations that provide other goods and services such as HMOs and other member-based structures? I will try to answer these two questions in the sections that follow. In this Section, I consider whether it is possible that the principle of non-hindrance demands that the state not tax these organizations.<sup>331</sup>

Perhaps the income tax could be viewed as a penalty that hinders nonprofit organizations from forming and operating. I suggested a similar argument above in Part V.B as to political organizations.

Before examining that question, though, it is necessary to establish some of the fundamental reasons for employing as close to a comprehensive, global, and uniform tax system as we can.<sup>332</sup> By a *comprehensive system*, I mean one like the Haig-Simons definition that as to an individual includes their consumption plus change in wealth during the time period.<sup>333</sup> By *global*, I mean one that treats all income the same no matter the source.<sup>334</sup> By *uniform*, I mean a tax system that applies the same rules to all income.<sup>335</sup>

From an administrability perspective, it makes sense to extend the income tax to all arenas of life transactions in order to prevent gaming of the system.<sup>336</sup> In other words, if there is individual consumption or accretion to wealth occurring, even if in a charitable or social welfare organization, it ought to be taxed. Additionally, because the same tax applies no matter the activity, there should be no impact on market efficiency. Finally, some find this system equitable because everyone's ability to pay is measured with the same measuring stick.<sup>337</sup>

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331. See, e.g., DEMOCRACY AND ITS CRITICS, *supra* note 35, at 170 ("In large democratic systems the right to form political parties and other political associations is necessary to voting equality, effective participation, enlightenment, and final control over the agenda.").

332. See, e.g., *Uniform Taxation*, *supra* note 1, at 49–52 (defining the terms comprehensive, global versus schedular, and uniform versus source treatment in an income tax system).

333. *Id.* at 46.

334. *Id.* at 49.

335. *Id.* at 51.

336. An obvious limit to such a claim is that taxing every entity may improperly wind up applying the same tax twice to a lot of different transactions.

337. Many contest that this ideal makes any sense at all. See *Uniform Taxation*, *supra* note 1, at 46–49 (discussing some of the literature on this debate).

Realistically though, this idea is not achievable because a legislative body will exempt some activities. In our income tax system, for instance, though we could arguably tax a gift, Congress exempts such income from our tax system.<sup>338</sup> Still, those exemptions should need to clear a high bar. The person who argues that a tax is a hindrance to the formation of a civil society organization as a rationale for exempting these organizations from income tax probably ought to bear the burden of proof. Exemption has real consequences to the functioning of the tax system including its efficiency, equity, and administrability.

Why might someone with political justice in mind argue that an organization of civil society ought not be taxed because these organizations should not be hindered by the state?

A traditional republican theorist would likely have no problem with the taxation of civil society groups. Such groups have a selfish will opposed to the general will of the state.<sup>339</sup> However, a modern republican theorist, as discussed above in Part II.B, who believes in non-domination, might contend it is important to allow some autonomous organizations outside the state to operate free from taxation. The theorist might argue that there are some cleavages, like religious ones, that are salient enough and the interest important enough that some associations ought to be able to pour their money into their endeavors without taxation.<sup>340</sup> For instance, a religious organization might argue that as a religious association it ought to have substantial separation from the state.<sup>341</sup> To tax the religious association would be to hinder an important part of civil society. Our treatment today of churches as to their relationship to the IRS likely derives from such a political justice notion. If the IRS wants to audit a church, it must go through extraordinary procedures,<sup>342</sup> and a church need not file an application for exemption<sup>343</sup> nor a tax return with the IRS.<sup>344</sup>

Weisbrod arguably makes a liberal case for non-hindrance in his government-failure theory.<sup>345</sup> As discussed above in Part IV, he assumes the government provides collective market goods desired mostly by the median voter. Tax exemption then allows minority voters to provide collective goods to cater to their interests.<sup>346</sup> Though Weisbrod suggests we might subsidize this activity to get the efficient

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338. 26 U.S.C. § 102.

339. See, e.g., DEMOCRACY AND ITS CRITICS, *supra* note 35, at 289 (quoting ROUSSEAU, *supra* note 294, at 212–13).

340. This could be seen in a sense as a light version of a consociational democratic order. See DEMOCRACY AND ITS CRITICS, *supra* note 35, at 256–58 (describing consociationalism).

341. Evelyn Brody argued we provide exemption to charitable organizations based on a sovereignty theory. *Of Sovereignty and Subsidy*, *supra* note 257, at 588.

342. 26 U.S.C. § 7611.

343. 26 U.S.C. § 508(c)(1)(A).

344. 26 U.S.C. § 6033(a)(3).

345. See *infra* Part III (citing *Theory of the Voluntary*, *supra* note 257, at 22).

346. See generally *Theory of the Voluntary*, *supra* note 257.



provision of the good, the liberal theorist might argue that we should not hinder this particular market activity. It is also consistent with the idea that we ought to let individuals voluntarily provide goods and services to themselves as much as possible.

It is hard to know what a deliberative-democratic theorist might argue. Civil society is supposed to be separate and independent from both the state and the economic forces of society. At the same time, there is a need to work to bring forth everyone's voice in an equal manner. Non-hindrance through exempting these organizations from tax might therefore appear to make some sense to strengthen that sector. However, my expectation is that the value of PVE would override this notion.

What are the problems from a political justice standpoint of this application of a non-hindrance principle? If there is income in the civil society organization in its Haig-Simon sense, the nontaxation is actual support. For instance, the failure to tax investment income would be to provide economic support to such activity to the extent of the tax rate times the income. In this sense, the political justice of this rationale is problematic. Why?

First, because of the vague social welfare standard, this policy is arbitrary. The subsidy flows from a market mechanism in that the government benefit flows in greater quantity to those individuals who happen to have resources and a particularly economically successful good or service. Those without the necessary resources or a less economically successful social welfare good or service will get little to no help from the state. Second, to the extent the activity is in the nature of an interest group, the unequal provision of a subsidy to organizations based on their success in the market should offend the need for equality to all individuals in political voice. Fundamentally, non-hindrance by not taxing is support of some to the exclusion of other interests.

If I am right, that democratic traditions would value PVE the most, then the democratic traditions would support only a narrow vision of non-hindrance. If that is so, then the social welfare standard is far too vague and broad to pass the requirements of political justice. The recognition of our shared endeavor as part of the state and the necessary belief in equality of citizens would build a strong presumption against such a provision.

#### D. *Advocacy Organizations*

By *advocacy organizations*, I mean those that lobby, are considered to intervene in a political campaign, and those that broadly advocate for a cause through education or legal processes. What does a political justice analysis suggest regarding the tax treatment associated with the advocacy organizations of the social welfare sector? For ease of analysis, in this section I look at the three specific advocacy organizations I

describe above in Part III.B. that give a sense of the scope of the types of advocacy organizations in the sector.

Based on social science research on collective action, tax exemption provides a subsidy in both an inefficient manner and a politically unjust way to tax exempt business leagues and labor unions.<sup>347</sup> Rather than enhancing PVE, this system exacerbates the democratically problematic inequality of resources.<sup>348</sup> Congress provides a subsidy to groups with an already strong political voice, and little to none to those with little political voice. We could enhance efficiency and political justice to end the exemption for both.<sup>349</sup> However, given the weak political voice of labor and the generally strong political voice of business, we could enhance efficiency and political justice by ending the business interest exemption while maintaining the exemption for labor unions.<sup>350</sup>

Does subsidizing advocacy organization activity through the income tax increase the number of people able to express their will to the government? In the case of clear partisan organizations typified by Crossroads GPS, described above in Part III.B, the only thing exemption does is amplify the voice of the politically strong.<sup>351</sup> A democratic political-justice theory thus would find against the provision of the subsidy to groups like Crossroads GPS supported by very wealthy interests through tax exemption. Its design violates PVE. That should be the case even in the instance of the liberal democratic theorist that supports a market model, because of the harm to PVE. Though the liberal theorist believes in market forces, he or she also believe in political voice neutrality. There are likely some social welfare organizations that advance interests that experience tremendous collective action challenges. Nevertheless, because the system is predominately accessible by those advocacy organizations that do not face these challenges, elimination of the subsidy seems like the only way to make the system more neutral as a PVE matter.

What about more broadly defined rights organizations like the NRA and ACLU? The NRA and ACLU broadly promote the interests of a large segment of society.<sup>352</sup> They both tend to align with either the Democratic or Republican party, but they also provide information on, and defend the rights of, citizens on matters of civil liberty. Some may strongly disagree with the right to guns as defended by the NRA, but at least on its face under any of the three traditions it is a matter that citizens might discuss and agree or disagree upon as a

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347. *Taxing the Unheavenly*, *supra* note 14, at 269; *Prop Up the Heavenly*, *supra* note 7, at 320.

348. Jordan Brennan, *United States Income Inequality: The Concept of Countervailing Power Revisited*, 39 J. POST KEYNESIAN ECON. 72, 72–73 (2016).

349. *Prop Up the Heavenly*, *supra* note 7, at 368.

350. *Id.*

351. *See supra* Part II.B.

352. *See supra* Part II.

fundamental right. The rights the ACLU defends represent core liberal rights, discussed above in Part II.B, that make a real part of each democratic tradition.

These organizations are both, in their own ways, trying to defend what citizens perceive to be civil liberties here in the United States. Do these organizations as fashioned increase the PVE or defend liberal rights? Or, like the partisan organization analysis, do they perhaps drown out those who would otherwise speak?

The ACLU directly protects civil liberties that are specifically critical to PVE, such as freedom of speech and association.<sup>353</sup> It is doubtful there could be a more deserving organization on this front. The republican, liberal, and deliberative democracy theorist would find this organization worthy.

The NRA is more complex. The protection of gun rights does not seem to go to typical civil liberties that might enhance PVE or basic civil rights. As we saw in the contract-failure and government-failure theories, the NRA is more mixed in its goals: protecting the interests of the business of making and selling guns; but also protecting gun owner rights and educating about the use of guns. On the one hand, the first interest describes an organization in the nature of a business league that I have previously argued does not deserve exemption.<sup>354</sup> On the other hand, the right to bear arms could be something we collectively agree ought to be supported. Arguably, the founders made such a conclusion in the Second Amendment to the Constitution.

It might be useful to consider the application of Hansmann's contract-failure theory. We might find that the market was already providing gun education without subsidy. Furthermore, gun manufacturers and distributors have a strong interest in advocating for the rights of gun owners. Under contract failure, then, we might say that such an activity should not qualify because there is no contract failure. By providing a subsidy, we make the market inefficient.

With respect to the ACLU, however, it is unlikely the market would provide these services. Lawyers provide these services to clients with means, but it is unlikely the lawyers would generate enough private clients to provide the services of the ACLU. Thus, the ACLU would be the type of organization that should be granted the status of exemption to benefit from a subsidy under contract failure.

How about partisan organizations, such as Crossroads GPS? If we think of these organizations as providing the service of advocating for a cause, there is no market inefficiency. Plenty of for-profit companies are willing to offer such services.<sup>355</sup> If we abstract out to the rights

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353. Am. Civil Liberties Union, Form 990: Return of Organization Exempt From Income Tax, *supra* note 216, pt. 1, § 1, at 1.

354. *Taxing the Unheavenly*, *supra* note 14.

355. See Nadra Nittle, *Nike, Dick's Sporting Goods, and Other Brands Got Political in 2018*, Vox (Dec. 17, 2018, 7:30 AM), <https://www.vox.com/the-goods/2018/12/17/>

represented instead, perhaps there is a contract failure involved. Those groups advocating for establishment candidates and causes likely face little collective-action challenges, while non-established candidates and causes may face enormous challenges. As I discussed in *Taxing the Unheavenly Chorus*, certain groups likely face few challenges in organizing.<sup>356</sup> Wealthy interests, for instance, will face little difficulty organizing themselves.<sup>357</sup> Because it is likely that the same wealthy and small groups are the ones taking advantage of the social welfare exemption, contract failure would likely find against the exemption of these organizations. The question we are left with is whether we could design an exemption system targeted only to those that face great collective action challenges. I do not believe we could.<sup>358</sup>

What about government failure? Can we justify exemption to advocacy social welfare organizations because these organizations provide collective services desired by a minority? This idea does not fit perfectly because advocacy organizations, like Crossroads GPS, do not primarily provide what we traditionally think of as end goods or services.<sup>359</sup> They are instead seeking such end goods and services from the government. Maybe we could envision advocacy organizations as providers of information to the state. But, the unequal provision of the subsidy to those who need it least under efficiency or political justice would seem to outweigh any value associated with this provision.

The government-failure idea has more promise in services provided by organizations like the ACLU and the NRA. The ACLU provides a service by representing people in court to protect their civil liberties. The NRA provides gun safety education and protects rights of gun owners.<sup>360</sup> Thus, again maybe we find some support for some narrow areas of advocacy organizations that protect civil rights at an individual level.

Where does this leave us on tax exemption? If we are to grant tax exemption to advocacy organizations, it should be highly conscripted to only those that are clearly providing protections to civil liberties, like the ACLU. The case for the ACLU seems particularly strong under the political-justice analysis. Congress could amend section 501(c)(4) to clarify that the only advocacy type organizations permitted are those actively protecting the civil liberties of the people in the

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1839699/companies-nike-patagonia-dicks-politics-kaepernik-trump-ads [https://perma.cc/P6TL-KWPT].

356. *Taxing the Unheavenly*, *supra* note 14, at 274.

357. *Id.*

358. Perhaps that we exempt labor unions suggests we could come up with other similar categories that face significant collective-action challenges.

359. Crossroads Grassroots Pol'y Strategies, Form 990: Return of Organization Exempt from Income Tax, *supra* note 217, pt. 3, § 1, at 2.

360. Nat'l Rifle Ass'n of Am., Form 990: Return of Organization Exempt From Income Tax, *supra* note 213, pt. 1, § 1, at 1.

United States. Congress would need to tightly define the meaning of civil liberties.

However, this might be a difficult political line to hold. Partisan groups would likely protest being left out while groups like the ACLU were permitted to maintain exemption. It also could likely be challenged on First Amendment grounds for discriminating on the basis of the content of speech. For these reasons, I would broadly recommend ending tax exemption for all advocacy-related organizations. It would therefore probably be strategically better to simply end exemption for these organizations. The value of eliminating exemption altogether for these groups is probably greater than the modest loss of incentives to civil liberty protecting organizations.

Alternatively, where does taxing advocacy-related social welfare organizations leave us? It would mean we would treat the activity as a business. The NRA, for instance, as a corporation, would be taxed on selling its services to its members and pay tax on its investment income at corporate rates. A group could choose to operate as a passthrough entity and get the tax attributes of such a situation. But again, it would pay tax as if it conducted a business like any other organization.

Finally, if advocacy-related social welfare organizations were simply taxable corporations, there would be potential regulatory problems. We might lose publicly disclosed information about these organizations in the annual tax returns they file.<sup>361</sup> Some might be pushed into the legal regime of political organizations under section 527. The more troubling possibility is that some might try migrating to charitable status under section 501(c)(3). The IRS would need to be vigilant in guarding the lines to that status. Many charitable organizations form advocacy organizations to get around the limitations on lobbying and political campaign intervention.<sup>362</sup> Arguably, the ability of charitable organizations to operate a social welfare organization to speak politically has made those limitations on speech constitutional.<sup>363</sup> As Ellen Aprill argued, we might also lose some of the boundary protecting function that these organizations arguably serve.<sup>364</sup> This presents a significant practical problem to this analysis, but I do not think it changes the fact that the operation of the system is politically unjust.

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361. Social welfare organizations currently file Form 990 and that form is publicly disclosable. It allows the public to generate information about these organizations. *Public Inspection and Disclosure of Form 990-T*, IRS, <https://www.irs.gov/charities-non-profits/charitable-organizations/public-inspection-and-disclosure-of-form-990-t/> (Feb. 13, 2020) [<https://perma.cc/M8J4-VSWW>].

362. 26 U.S.C. § 501(c)(3).

363. *Regan v. Tax'n With Representation of Wash.*, 461 U.S. 540, 552–53 (1983) (Blackmun, J., concurring) (arguing that the restrictions on lobbying and election activity passed constitutional muster because the IRS administered the law to allow people involved with the operation to form social welfare organizations and PACs to speak).

364. See *Examining the Landscape*, *supra* note 9, at 376.

In the end, these organizations could carry out their activity as either taxable or nontaxable as a section 527 political organization. If these organizations were pushed into section 527, we would preserve public disclosure of their activities.

### E. *Health Service and Insurance*

What about health service and insurance? Here I focus on the Delta Dental example. We could likely improve social welfare by providing more dental insurance for Americans, particularly poor children and the elderly. According to some statistics, approximately 77% of Americans had dental health insurance in 2016.<sup>365</sup> Those without dental insurance tend to receive less dental care and in turn have more health issues like heart disease, osteoporosis, and diabetes.<sup>366</sup>

Nevertheless, a political justice analysis would find tax exemption as designed problematic. The vague social welfare standard provides little clarity on what is permitted. Tax exemption for social welfare organizations provides a subsidy to individuals to seek collective services outside of a collective decision-making process. That dental insurance companies exist within this vague idea is no more than random, but they do, and only the individuals who control the group—likely the managers of the company—get a vote on how the services will be provided. This violates PVE. It allows groups that have the capacity to organize to receive a subsidy from the government with little in the way of democratically directed limits. Thus, a political-justice analysis does not generally support tax exemption as currently structured for the provision of most health care services.

A contract-failure analysis does not support exemption either. Delta Dental, discussed above in Part III.B, appears to face no challenges selling dental insurance. It is also unlikely to face challenges generating the funds it needs to operate its business through borrowing or customer generation. It is carrying out an activity that is broadly carried out in a taxable for-profit manner to a public who pays the price associated with the activity. Though there appears to be a real crisis of lack of access to dental care, the social welfare organization tax rules are not designed to solve this problem. Though Delta Dental may happen to relieve those issues in some part, it is not because of the tax law.

A government-failure analysis is not particularly enlightening. Though there is a dearth of dental services for the poor and the eld-

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365. NAT'L ASS'N OF DENTAL PLANS, *Who Has Dental Benefits Today?*, [https://www.nadp.org/Dental\\_Benefits\\_Basics/Dental\\_bb\\_1.aspx#\\_ftnref1](https://www.nadp.org/Dental_Benefits_Basics/Dental_bb_1.aspx#_ftnref1) [<https://perma.cc/X3U2-3DR9>].

366. Meera Jagannathan, *Why 37 Million People in the U.S. Don't have Dental Coverage — and the Painful Price They Pay*, MARKET WATCH (July 27, 2019, 4:40 PM), <https://www.marketwatch.com/story/dental-visits-start-declining-around-age-80-and-there-may-be-a-painful-price-to-pay-2019-07-25> [<https://perma.cc/8HAS-KXJV>].

erly, the social welfare rules again are not designed to ensure these needs are met. Also, it is odd to think of dental insurance as some minority voter desired service as Weisbrod proposed in his theory because dental insurance would seem to be desired by all.

Where does this leave us? Arguably, the subsidy of tax exemption has been provided through Congress and thus through a democratic process. How could we find this to violate PVE? There is a crisis of a lack of access to dental care. The problem is that the use of the subsidy by dental insurance providers was not democratically chosen. They arbitrarily fit into the vague standard Congress established. Congress could largely correct this by enacting rules on dental care that ensure dental insurance social welfare organizations meet real collective interest needs rather than just letting the IRS sort things out.

To summarize, to provide exemption in the case of healthcare is to support a transactional pluralism. By *transactional pluralism*, I mean governance intended to honor and support groups making and carrying out collective decisions to benefit democracy that allows the market to make collective decisions on the public's behalf. We likely think of these market-based systems as akin to a voting mechanism where the "market decides" through democratic votes. But these systems are far from voting systems, and instead, reward individuals with government aid based on their money and success in the market rather than operating to honor PVE.

#### F. *Community Clubs/Homeowners' Associations*

In this Section, I consider community clubs and homeowners' associations. I discuss each of these organizations in Part III.B.

What does political justice have to say about these organizations? Does their tax status help or harm PVE or civil rights? Given that none of these organizations are likely playing a significant role in advocacy at the broad governmental level, there is no strong reason to believe they might use the subsidy to drown out other interests at the governmental level like advocacy organizations. However, it is possible that these organizations are operating at a local level in ways that are harmful to the democratic nature of the larger municipality. For instance, homeowners' associations may be providing security primarily to the immediate neighborhood in a way that is not available and causes a misallocation of community resources as compared to other areas. Community service clubs may provide a place for businessmen and women to have extra access to influence local politics.

At the same time, they likely serve important democratic functions.<sup>367</sup> Community clubs and homeowners' associations both assist

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367. See DIMINISHED DEMOCRACY, *supra* note 291, at 23–24 (making the case that the loss of community-based clubs around the United States has been harmful to our democratic enterprise).

in generating and disseminating information across the community on broad important topics. As noted in Part III.A, the IRS requires homeowners' associations to be broadly open to the public and not provide individual services.<sup>368</sup> Assuming community clubs and homeowners' associations are genuinely open to the broader community and not substantially providing services to individual members, there is little likelihood that these associations will harm popular will and may even enhance deliberative democratic procedures. As long as these clubs and associations stay relatively small on a revenue and assets basis, as it appears from a look at Form 990s described above in Part III.B, maintaining tax exemption is probably inoffensive. They likely further values of each of liberal, republican, and deliberative-democratic traditions by facilitating important civil society dialogue at a local level.

What about contract and government failure? Both service clubs and homeowners' associations likely face real contract failure. It is difficult to organize large groups of neighbors into associations that benefit a broad segment of land.<sup>369</sup> Similarly, it is difficult to maintain community clubs focused on service rather than primarily about social mingling, as social clubs work.<sup>370</sup> They are also both likely to face challenges in raising necessary funds for their operations. In a government failure sense, large homeowners' associations that provide streets, parking, parks and other community attributes fit into the idea of allowing smaller groups of individuals to come up with a broad-based governmental solution to a community problem. And maybe these clubs are collective activities that are sought by some but there is not enough interest for government to provide for them. Thus, contract failure and government failure likely support these types of activities. Maybe that analysis could extend out to other community clubs like kids' sports groups.

The lack of the larger community to have the right to vote on activities of a homeowners' association may raise some issues of political justice. A community club that is not broadly open to all may also raise concerns. However, given the low levels of dollars with respect to both community clubs and homeowners' associations and the other values that they bring in both an efficiency sense and a democratic sense, these may be small concerns. This suggests though that the IRS ought to require the organizations to be broadly open to the public. It may be wise to limit the size in revenue and assets of these groups. Once they get too large, they may no longer be serving the same type of purpose that they serve as smaller units.

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368. See *supra* Part II.A.

369. See *supra* Part III.B.

370. See DIMINISHED DEMOCRACY, *supra* note 291, at 23 (documenting the ways in which these types of clubs have slowly disappeared in American life).



G. *IRS as the Arbiter of Legitimate Public Activity Harms Us and the IRS*

As discussed in Part II.B, one of the principles of a well-functioning democracy and of social justice is that justice be publicly seen. People must be seen to be equally treated, and the government must be operated in a transparent matter.<sup>371</sup> Placing a collective choice into the hands of IRS agents with a vague standard violates that principle. It takes away the equal treatment of each citizen by removing them from participating in a collective choice. Additionally, the IRS's choice made individually by approving applications is not a transparent one. Because of the protection of taxpayer privacy,<sup>372</sup> much that goes into the IRS decision is kept from public view. Thus, by making the IRS the arbiter of the standard by which an organization furthers "social welfare," Congress harms both equal treatment and transparency.

The Tea Party Crisis highlights this difficulty.<sup>373</sup> Whether true or not, many in the public broadly believed that the IRS was engaged in biased treatment of collective political activity. Placing the IRS in that position harmed us all.<sup>374</sup> Problematically, because the IRS cannot be fully transparent about who qualifies, the IRS can never appear to publicly do justice. Furthermore, in forcing the IRS to make these calls of whether citizen collective activity promotes "social welfare," Congress pollutes the appearance of justice of the IRS being seen to fairly and impartially collect revenue.

Congress could partially correct these problems by drawing sharper rules. It could define the rules of each different type of social welfare organization. Because the IRS would likely still be seen to take a collective decision away from the public, the arrangement would remain problematic. Still, the greater clarity in rules would create a much greater sense of political justice.

This is not an argument that administrative bureaucrats and experts cannot engage in rulemaking—they can and should. However, the nature of this particular call is so related to our sense of political justice that the IRS involvement in this matter puts the IRS in a bad position. It might be possible for this arrangement to work for an agency whose purpose was solely this matter of determining the goodness of the activity of nonprofits.<sup>375</sup> However, because the IRS has a primary pur-

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371. See *supra* Part I.B.

372. 26 U.S.C. §§ 6103, 6104(c).

373. See *supra* Part II.A.

374. See *supra* Part II.A.

375. There are a number of scholars who have called for a new organization to oversee the nonprofit sector. See Marcus S. Owens, *Charity Oversight: An Alternative Approach*, HAUSER CTR. FOR NONPROFIT ORGS., Working Paper 33.3, 11 (2006), [https://cpl.hks.harvard.edu/files/cpl/files/workingpaper\\_33.4.pdf](https://cpl.hks.harvard.edu/files/cpl/files/workingpaper_33.4.pdf) [<https://perma.cc/VSW5-L9UJ>]; Terri Lynn Helge, *Policing the Good Guys: Regulation of the Charitable Sector Through a Federal Charity Oversight Board*, 19 CORNELL J.L. & PUB. POL'Y 1, 70 (2009); Lloyd Hitoshi Mayer, "The Better Part of Valour Is Discretion":

pose of collecting revenue, which requires the agency to be perceived as just in fact, the entanglement of the IRS in this fraught matter makes this social welfare organization determination function harmful.

H. *Assuming Social Welfare Organizations Maintain Exemption, What Ought We to Do, Keeping Political Justice in Mind?*

It is unlikely Congress will end exemption for social welfare organizations. Assuming so, there are a number of changes that could be made to the tax legal regime to improve political justice.

First, as noted above, Congress could enact detailed rules on social welfare organizations. This would give greater legitimacy to the actions of the IRS. It is absurd to make the IRS decide whether health insurance operations ought to receive tax exemption. Congress provides significant requirements for insurers under the Affordable Care Act (“ACA”), so it could do the same for other health insurance operations. It could also decide to eliminate the HMO from this sphere altogether.

Additionally, taking a cue from deliberative democracy, Congress could include rules to make social welfare organizations emblems of a civil society that create a healthy and effective public sphere. Under a political justice conception, an organization like the ACLU, by forcefully protecting liberal rights, fulfills that role. The key is these organizations should either exemplify equality of citizens or protect liberal civil rights. This would mean that rules should be designed to enhance the deliberative and inclusive nature of social welfare organizations. Homeowners’ associations could be required to operate democratically and with some level of responsiveness to the larger community in which they sit. As to advocacy organizations, perhaps there could be an emphasis on truly educating Congress. Each organization might have to always consider, and present in genuine fashion, other approaches to an issue.<sup>376</sup> They could be a genuine devil’s advocate to their own proposals.

The difficulty with such an effort is there is no simple language here to make such rules, and it is surely impractical. Such rules might also prove harmful to minority interests by forcing such organizations to engage and include majority interests that despise their particular way

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*Should the IRS Change or Surrender Its Oversight of Tax-Exempt Organizations?*, 7 COLUM. J. TAX L. 80, 113–15 (2016).

376. This has the potential to be offensive and misused if organizations are forced to describe matters that they firmly do not believe. Imagine a gay rights organization being forced to discuss the potential merits of gay conversion therapy. Also, this is arguably the “full and fair exposition test” of the IRS to define ‘educational’ as to charitable organizations. Treas. Reg. § 1.501(c)(3)-1(d)(3) (2017). The D.C. Circuit Court of Appeals found that test unconstitutional because it was too vague for a person to understand before acting. *Big Mama Rag, Inc. v. United States*, 631 F.2d 1030, 1039 (D.C. Cir. 1980).

of life. It harkens back to the failed IRS full and fair exposition test for determining whether an organization was educational.<sup>377</sup> These types of challenges make me think it better to end exemption for social welfare organizations instead.

Finally, given the greater selfish nature of social welfare organizations than charitable ones, Congress ought to change a few tax matters. Social welfare organizations should have to pay an investment income tax. Most scholars today make this claim and it is the right thing to do for PVE.<sup>378</sup> Additionally, and in the same vein, Congress should also require a taxpayer to recognize gain on appreciated assets transferred to a social welfare organization.<sup>379</sup> These two actions would go a long way to equalizing any issues associated with nonprofits. Finally, a gift to a social welfare organization should be subject to the gift tax as well.

### I. *Application to Charitable Organizations*

While this analysis does not explicitly apply to charitable organizations, it suggests that there might be some significant problems with providing tax exemption to charitable organizations. Those organizations that provide political advocacy within this sector likely ought to be suspect from a political justice standpoint. A big dividing line, though, is the fact that there is a much larger body of law defining what these collective goods provided by the charitable sector are, and a sense that we have collectively agreed on a fairly large part of what is contained within exemption for charitable organizations. Nevertheless, the collective action challenges for some combined with the ease of access for others may likewise call into question the political justice of exempting charitable organizations from the income tax.

Hospitals make up half of the revenue of the charitable sector.<sup>380</sup> Maybe these organizations ought not qualify as currently structured. Like health insurance in section 501(c)(4), the standard from Congress is quite vague. While Congress made the rules regarding nonprofit hospitals modestly more rigorous in the ACA,<sup>381</sup> the requirements for meeting the charitable standard of a hospital are still quite modest.<sup>382</sup> One of the new provisions is that hospitals must an-

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377. *Big Mama Rag, Inc. v. United States*, 494 F. Supp. 473, 481 (D.D.C. 1979).

378. *See* Part IV.

379. Congress could extend 26 U.S.C. § 84 to apply to contributions to social welfare organizations (it currently makes the contribution of appreciated assets to a political organization a realization event). Roger Colinvaux, *Political Activity Limits and Tax Exemption: A Gordian's Knot*, 34 VA. TAX REV. 1, 21 (2014).

380. Nat'l Ctr. for Charitable Statistics, *The Nonprofit Sector in Brief 2019*, URB. INST. (June 4, 2020), <https://nccs.urban.org/publication/nonprofit-sector-brief-2019#the-nonprofit-sector-in-brief-2019> [https://perma.cc/4CAM-2X2L].

381. 26 U.S.C. § 501(r).

382. Rev. Rul. 69-545, 1969-2 C.B. 117 remains the standard for determining whether a hospital is exempt.

nually produce a community health needs assessment that evaluates the health needs of the community.<sup>383</sup> However, there is no accountability mechanism for ensuring the hospital is actually meeting those health needs. Educational charitable organizations from universities to charter schools are also likely fertile territory for examining the wisdom of exemption.

## VI. CONCLUSION

I have applied a political justice analysis to social welfare organizations. This is only a small part of the Code, and it is only a small part of tax-exempt organizations. Where else might this analysis have power? The next natural place to bring the analysis is charitable organizations. I do not make any conclusions here, but I think it suggests that the charitable sector maybe ought to be significantly revised.

Though a political justice analysis does not provide all the tools to answer questions of the rationale for tax exemption, it enhances the analysis. It suggests that much of the field of social welfare organizations, including advocacy organizations and health insurance organizations, would be best as taxable entities rather than tax exempt. However, it seems to provide some support for smaller, truly community-based, open organizations. And, it may justify exemption in the case of a true civil liberty-defending organization such as the ACLU. Nevertheless, politically, this is likely a difficult line to hold. Reducing the number of organizations that fit into this category and making them taxable would likely improve the function of the IRS and its perception as a fair organization by removing from its jurisdiction the necessity to make toxic political calls.

Additionally, this political justice analysis has potential power to help build a more just income tax regime. It certainly has impact at the level of the tax base and the progressive nature of the rate. But additionally, it is likely there are a number of other Code-level choices where political justice might clearly play a role. We maintain a number of incentives in the Code aimed at community redevelopment like New Market tax credits and opportunity zones. In future articles, I plan to look deeper both within the tax-exempt sector and without. I do not examine these other Code sections here, but I believe this analysis of social welfare organizations suggests that a political justice critique can and should be applied to the entirety of the Code.

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383. 26 U.S.C. § 501(r)(3); CONG. RSCH. SERV., 501(c)(3) HOSPITALS AND THE COMMUNITY BENEFIT STANDARD 3 (May 12, 2010), <https://crsreports.congress.gov/product/pdf/RL/RL34605/9> [<https://perma.cc/NB94-5R4M>].

